S. Hrg. 104–210

104

THE SMALL BUSINESS INVESTMENT COMPANY PROGRAM

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

JULY 13, 1995

Printed for the use of the Committee on Small Business

U.S. GOVERNMENT PRINTING OFFICE

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SMALL BUSINESS INVESTMENT COMPANY PROGRAM

THURSDAY, JULY 13, 1995

United States Senate,
Committee on Small Business,
Washington, D.C.

The committee met, pursuant to notice, at 10:15 a.m., in room SR–428A, Russell Senate Office Building, the Honorable Christopher S. Bond, Chairman of the Committee, presiding.

Present: Senator Bond.

OPENING STATEMENT OF THE HONORABLE CHRISTOPHER S. BOND, CHAIRMAN, COMMITTEE ON SMALL BUSINESS, AND A UNITED STATES SENATOR FROM MISSOURI

Chairman Bond. Now we will turn to a hearing on the Small Business Investment Company Program. We invite the first panel to come forward.

We are strongly interested in this program. The SBICs have provided much needed capital to small business for nearly four decades. Tens of thousands of small businesses have benefited from the program. We are likely, in the news media, to read about high-flying medical device companies that receive funds from a large well-known venture capital firm. These investments produce large returns within short periods of time, and are very lucrative investments for venture capital firms. And I might add, there is a great deal of risk associated with them.

But for every story like those, there are others about companies that make up the backbone of the business community that need investment capital. These are the companies that provide wood products for new homes, automobile parts for new cars, railroad equipment or other equipment that we use in our day-to-day lives. They are the "salt of the earth" companies. They create jobs, pay taxes, and create hope for hundreds of thousands of families across our Nation. While they may not always be the "gazelles" we read about in INC. Magazine, they are just as important to our Nation's economy as every high-flying, high-tech company.

Where do these companies turn for infusions of equity and operating capital? Today we are going to hear from companies which were unable to raise money from banks and larger investment firms, and found help only after turning to SBA-licensed Small Business Investment Companies. It is not unusual for SBICs to provide crucial investment capital to these companies at critical times to support their expansion and growth.

First we are going to hear three witnesses who received help from SBICs and SSBICs at important times in their business lives. Following that, we will hear from SBA and private sector witnesses who will testify about how we might improve the SBIC program to enable it to help more small businesses and entrepreneurs.

I would also invite the panelists on this first panel to share with us any views that they may have on the reforms, of which I am sure they are well aware.

With that, I would say to our panelists, who have provided excellent written statements—if you could summarize your oral testimony in five to eight minutes. We will have the full written testimony for the record. We will have a few questions, but obviously this is a very busy day and we are going to be seeing people coming in and out throughout the hearing. So the written testimony will have the greatest impact.

Our first panel includes Mr. Gerald H. Johnson, chairman and chief executive officer, Williams Brothers Lumber Company, Duluth, Georgia; Mr. Ronald Manganiello, chairman and chief executive officer, Hanger Orthopedic Group in New Canaan, Connecticut; and Mr. Ronald L. Thompson, chairman and chief executive officer, Midwest Stamping Company in Bowling Green, Ohio, but we still claim him as a good friend from St. Louis.

Mr. Johnson, would you care to begin?

STATEMENT OF GERALD H. JOHNSON, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, WILLIAMS BROS. LUMBER COMPANY, DULUTH, GEORGIA

Mr. JOHNSON. Yes sir, good morning.

I am Gerald Johnson. I am the chairman and chief executive officer of Williams Bros. Lumber Company, headquartered in Duluth, Georgia. We have seven locations in six different counties in Metro Atlanta. I appreciate this opportunity to testify before the Committee today, and offer reasons why we believe the SBIC companies involved in our financing are a great benefit to companies such as ours.

A little over 5 years ago, in early 1990, we had the opportunity to buy the assets of Williams Bros. Lumber Company from Blue Circle PLC, a UK publicly traded company. The Company, at that time, met the definition that Mr. Lader has used for the type of company that the SBA tries to reach. The Company was marginal, but it had potential.

The transaction required much more cash and financing than my partner and I were able to come up with on our own, so we immediately began a search for financing and a venture capital partner. Over the first 3 months of 1990, we talked to approximately 15 different sources of potential capital. The responses from those parties ranged all the way from we are not interested in even talking with you because you are involved in the construction industry in Atlanta, and at that time the construction industry was in the pits, all the way down to two parties who were interested. One of those parties was a private investor that wanted 80 percent of the Company to do the financing. My partner and I were not willing to put everything we had on the line for a 20 percent interest in the Company.

The other party that expressed an interest was Allied Capital Corporation here in Washington. We had sent a package to them in early March 1990. They requested that we come up on March 23 for a meeting, which we did. Based on that meeting and their review, they made a commitment to finance the transaction and on May 18, 1990, we were able to close the deal and buy the assets of the Company.

We are convinced that had we not been able to close the deal as soon as we did with Blue Circle, they would have liquidated the Company, sold all the assets, and the 90 people that we took with us would have been out on the street looking for something else to do.

The form of financing that we received was subordinated debt, which we had to have to get a working capital line with a commercial bank. They also financed our real estate on a term loan, which the commercial banks would not touch at that time, and they gave us a bridge loan because we did not have a commercial bank in tow at that time.

We went to every bank in Atlanta to try to get them to finance the working capital side of the loan. After we had a commitment from Allied, none of the banks in Atlanta would even talk to us because of the problems in the construction industry at that time. We finally were able to do a working capital loan with LaSalle National Bank in Chicago based on Allied's commitment, closed the transaction in July 1990, and paid down the bridge loan to Allied.

We proved in the first 2 years that we were a marginal company as the economy continued to go down after we bought the Company and we lost one location due to a fire. The first year we did $22 million in revenues and lost $500,000. Allied stood by us and believed in what we were trying to do. We improved in the second year to a little better than break even and over the last 3 years, have increased our revenues to $105 million. Our employees have gone from 90 to 350, and we have started to realize the potential over the last 3 years that we are capable of.

We would like to commend Mr. Lader on what he is trying to do with the SBA. His objective is to do what we have to do every day in the business world, and that is to look for ways to continually cut our costs, while at the same time improving the product or service that we deliver, or as he would put it, "doing more with less."

He is dealing with a difficult set of circumstances. All of us have gone through that, and we think he is doing a great job. We also believe that without the service provided by the SBA and the SBICs, a lot of companies such as ours and our people would have been left by the wayside. We think it is important that those services are continued in some fashion.

I appreciate again this opportunity and I would be glad to answer any questions that you may have.

[The prepared statement of Mr. Johnson follows:]

TESTIMONY BEFORE U. S. SENATE COMMITTEE ON SMALL BUSINESS

BY GERALD H. JOHNSON

CHAIRMAN AND CEO CALHOUN/JOHNSON CO.

DBA WILLIAMS BROS. LUMBER COMPANY

We, at Williams Bros. Lumber Company, welcome the opportunity to testify before the U. S. Senate Committee on Small Business regarding the SBA's Small Business Investment Company Program. My name is Jerry Johnson and I am the Chairman and CEO of Williams Bros. Lumber Company. Together with my partner Sonny Calhoun, we own all of the stock of the Company. I graduated from the University of Houston in 1968 and became a CPA in 1969. My career includes seven years with Price Waterhouse and 13 years in industry before I came to Williams Bros. in 1988 as CFO.

The Company was founded by the William's family in 1922 to provide building products to contractors servicing the Atlanta market. In 1965, the Company diversified into the ready mix concrete business which became its second major business group behind the distribution and manufacturing of lumber and lumber products. The Company formed its third group in 1977 with the addition of masonry operations. In 1985, the William's family sold the Company to Blue Circle, America, a subsidiary of Blue Circle PLC, an English publicly held company and the number two cement producer in the world. Blue Circle bought the business due to the captive market for it's cement in the Concrete and Block Groups. By 1988, the total sales of Williams Bros. were $300 million with the Lumber Group contributing $80 million. Since the Lumber Group did not fit within the basic core business of Blue Circle, and the demand for building materials was declining, Blue Circle in mid 1988 engaged Ernst & Whinney to prepare and distribute an offering document in an effort to sell the assets of the Lumber Group. When this effort failed in mid 1989, Blue Circle asked me to move from my position as CFO of Williams Bros. to the President of the Lumber Group with the intent of down-sizing the business to a saleable product. Since my background was primarily in finance, I relied heavily on my partner, Sonny Calhoun, who was a vice president of the lumber group at that time and who had been in the lumber business his entire career. During late 1989 and early 1990, we closed six yards and a truss facility and sold the wholesale distribution and millwork facilities. We then put the remaining four yards and related assets on the market.

Sonny and I decided to make an offer for the assets of the

Lumber Group and we also generated two offers from independent outside organizations for the purchase of the assets. Since both Sonny and I came from meager backgrounds and did not have access to the funds required to purchase the assets of the Lumber Group, we began our search for an equity partner and/or subordinated financing which would be required before we could enter into a normal asset based lending relationship with a bank. Sonny and I split up and talked to approximately fifteen potential sources of equity and/or subordinated financing until we were put in touch with Allied Capital Corporation in Washington, DC. After forwarding a package to Allied for its review, they requested that Sonny and I come to Washington for an interview on March 23, 1990. After the normal due diligence was preformed by Allied, we were able to close the transaction on May 18, 1990, within two months of our first meeting with Allied in Washington. The financing provided by Allied enabled us to enter into a revolving loan, asset based lending agreement with LaSalle National Bank in Chicago on July 11, 1990.

Since the construction of both single and multi family housing had bottomed out in 1990, not a single bank in Atlanta would even talk to us about asset based lending and the only other source of equity or subordinated debt financing that even expressed an interest would have required 80% of the Company be given as warrants for the financing compared to Allied's proposal of 60%. It is my firm belief that had Allied not provided us with the funds to buy the assets of the Lumber Group, the business simply would have been liquidated by Blue Circle and the 90 people employed at that time would have been terminated.

Our offer was ultimately accepted by Blue Circle since it contained more cash and less seller financing than the other offers. As a result, in May 1990, Calhoun/Johnson Co. purchased the Duluth, Marietta and Conyers yards and leased the downtown yard. The supporting assets for these facilities were also acquired. We do know that one of the other companies that was interested in purchasing the assets ultimately went out of business. We feel that the other interested company would not have been successful due to the continuing downturn in the economy and the construction industry well into 1991.

In 1992, a new location in Peachtree City was opened and in 1993 the downtown location was closed and a millwork facility was opened in Lithonia. In 1994 the Company opened a truss and rail reload facility in Norcross and in 1995 opened its newest location, a yard in Villa Rica. The Company now has a total of seven locations serving the metro Atlanta area. In the fiscal year ended April 30, 1995, the Company generated more revenues and profits than it did in 1988 with 10 yards and sawmill, truss, wholesale

and millwork facilities.

In the five years that we have been in business, we have increased revenues from $22 million in the first year to $105 million in the fifth year. Over the same period, our number of employees has increased from 90 when we bought the company to 350 today. None of this would have been possible without the financing provided by Allied Capital Corporation and it's SBIC corporations.

Since we have grown the business nearly 500 percent in five years, our need for financing has increased correspondingly. All of our growth has been financed out of an increase in our revolver with LaSalle National Bank, retained earnings and additional subordinating debt supplied by Allied. Our relationship with both Allied and LaSalle has been excellent over the years and has been mutually beneficial for all parties involved. With the help of Allied, Williams Bros. Lumber Company provides jobs for over 350 families, generates over $100 million in revenues per year and paid over $1.7 million in federal and state income taxes in the last two years.

My only regret is that I did not have more knowledge about the SBIC programs when we purchased the Company. This may have saved a significant fee that was paid to the person who put us in contact with Allied.

Finally, the Atlanta Business Chronicle recently interviewed Mr. Philip Lader while he was in town for a Cobb Chamber of Commerce function. It appears that Mr. Lader is doing a commendable job as the SBA Administrator. He is striving, as all of us in business must do every day to survive, to reduce expenses while improving the product or service offered or " doing more with less". According to Mr. Lader, his $800 million budget this year resulted in the private sector putting $15 billion into small business as loans or investments. We commend Mr. Lader for a job well done in meeting the needs of small business, the backbone of America.

Thank you for your time and this opportunity.

Chairman BOND. Thank you, Mr. Johnson. We will turn to Mr. Manganiello.

STATEMENT OF RONALD J. MANGANIELLO, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, HANGER ORTHOPEDIC GROUP, INC., NEW CANAAN, CONNECTICUT

Mr. MANGANIELLO. Thank you, Mr. Chairman. I am Ronald Manganiello. I am the chairman and chief executive officer of Hanger Orthopedic Group, and you did pronounce my name correctly, believe it or not. It is not often that people do pronounce it correctly.

Hanger is a publicly traded company whose shares trade on the American Stock Exchange and we are one of the Nation's largest providers of prosthetic or artificial limbs and orthotic or braces patient care services in the United States. Hanger has a proud history dating back to 1861 when a cannonball shattered the leg of James Edward Hanger at the Battle of Phillipi, and he became the first amputee of the American Civil War. He was a Confederate Soldier from Churchville, Virginia, who was left for dead on the battlefield. He was rescued by the Union Army, where one of the Union Army surgeons amputated his leg.

Disabled and dissatisfied with his standard-issue peg leg, this 18-year-old creative engineering student designed the first articulating joint, or moving joint, for an artificial leg and he started his business right there on the battlefield of the Civil War.

The company has operated continuously since 1861. In the mid–1980s, however, the company faced its most serious challenge, and that was internal strife. If we had not acquired the company, it is probable that they would not have survived intact and 130-plus year history of providing innovative solutions to these patient care problems would have been lost forever.

In 1986, after a 12-year career in the financial services industry, I invested basically my life savings and, together with a small group of investors, acquired the J.E. Hanger Company. At that time, the company was a private company with $6 million in sales, eight officers, and 100 employees. Today, the company has sales, or this year will post sales of approximately $56 million with 85 offices, and we employee over 500 employees. The economic benefit of this growth, in terms of Federal and local taxes, jobs created, and payroll taxes is significant.

We are a success story. In 1993, Hanger was awarded the prestigious Portfolio Company of the Year Award by NASBIC, the National Association of SBICs. We were included in the 1993 INC. 100 as the 79th fastest growing public company in the United States. We also were the recipient of the 1994 Arthur Anderson "Fast Track" Award.

The biggest problem we faced in financing our acquisition in 1986 was that the banks would only lend on a fully collateralized basis. We could only borrow up to a certain percentage of the company's current tangible assets, irrespective of the fact that the company's cash-flow far exceeded the requirements to service more than that debt. In addition, the banks were unable to provide any equity capital and the banks did not give us any value or consider

130-plus years of history as an asset. They do not lend on good will. It was not enough.

The SBIC in this case made up the shortfall, provided unsecured debt and equity capital. They worked quickly and they provided invaluable assistance in due diligence and deal structure. They introduced us to senior lenders.

Post-transaction the SBICs gave us flexibility in interest payments and principal payments, which the banks would never have been able to offer us.

Most capital that is available to smaller middle market companies brings with it little or no value added. Typically, a bank parks its money and checks in periodically to track progress. Conversely, the SBICs we worked with brought considerable experience in acquiring, financing, and operating businesses in our market segment.

By 1992, the senior lender was paid off in full, plus interest. The SBIC has been handsomely rewarded and today is sitting with an annualized internal rate of return of over 30 percent. Few people are aware that in their youth, companies like Intel, Apple Computer, Federal Express were all financed by SBICs and since larger funds of capital have all but abandoned the small business, SBIC financing is a very important source of capital and more important than ever before.

SBICs function as incubators for expansion-stage companies like Hanger, and in so doing, provide the necessary capital and service to grow and expand.

Thank you.

[The prepared statement of Mr. Manganiello follows:]

Ronald J. Manganiello
Chairman and Chief Executive Officer
Hanger Orthopedic Group, Inc.
107 Cherry Street
New Canaan, CT 06840
(203) 966-9990

Testimony Before
The United States Senate Committee on Small Business

Good morning Mr. Chairman and members of the Committee on Small Business. My name is Ronald J. Manganiello and I maintain my office and reside in the great state of Connecticut.

I am Chairman of the Board of Directors and Chief Executive Officer of Hanger Orthopedic Group, Inc. Hanger is a publicly held company whose shares trade on the American Stock Exchange and is one of the nation's largest providers of patient care services for orthotics (braces) and prosthetics (artificial limbs). We operate in a relatively small niche segment of the health care services industry. We also manufacture and distribute components and patented proprietary finished patient care products to the orthotic and prosthetic industry.

Hanger has a proud history dating back to 1861 when a cannonball shattered the leg of James Edward Hanger at the Battle of Phillipi, and he became the first amputee of the American Civil War. He was a Confederate soldier from Churchville, Virginia who was left for dead on the battlefield. He was rescued by the Union army, where one of their surgeons amputated his leg. Disabled and dissatisfied with his standard-issue peg leg, this creative eighteen year old engineering student devised and built an innovative artificial leg with articulating (or moving) joints. Soon the Virginia legislature commissioned him to manufacture and fit artificial limbs for other wounded veterans and the company was formed right on the battlefield.

Hanger has operated continuously since then and has survived a variety of political and economic upheavals over the years. In the mid 1980's, however, the company was confronted with it's most serious challenge - internal strife. If we had not acquired the company, it is possible that it may not have survived in tact. It is possible that a 130+ year history of providing innovative solutions and quality patient care for the physically challenged would have been broken up, sold off piecemeal and lost forever.

In 1986, after a 12 year career in the financial services industry, I invested a substantial portion of my life savings and together with a small group of investors, acquired the J.E. Hanger Company. At that time, Hanger was a private company with sales of $6 million, 8 offices, and 100 employees. In 1995, Hanger will post sales of approximately $56 million, with 85 offices, and employ over 500 people. The economic impact of this growth in terms of federal and local taxes, jobs created and payroll taxes is significant.

We are a success story. In 1993, Hanger was awarded the prestigious Portfolio Company of the Year Award by NASBIC (the National Association of Small Business Investment Companies) in recognition of our tremendous success as a small business, and outstanding contributions to our employees and community, measured in job creation, taxes paid and other socioeconomic benefits. We were included in the 1993 *INC. 100* as the 79th fastest growing public company in America and were awarded the 1994 Arthur Anderson "Fast Track" Award. In addition, because of my role as CEO, I was a finalist in both the 1993 and 1994 Entrepreneur of the Year Awards. If it were not for SBIC financing however, I would not be sitting here today. Had SBIC financing not been available, we would not have been able to secure the necessary financing to acquire Hanger or finance our growth over the years.

The biggest problem we faced in financing our acquisition in 1986 was that the banks would only lend on a fully collateralized basis. We could only borrow up to a certain percentage of the company's current tangible assets, irrespective of the fact that the company's cash flow could service additional debt. In addition, the banks were unable to provide any equity investment. Banks, don't consider 130 years of good will as a collateral asset. They don't lend on good will. Well, that just wasn't enough. The SBIC - in this case, BT Capital, an SBIC affiliate of Bankers Trust Corporation and later, Chemical Venture Partners, an SBIC affiliate of Chemical Bank, made up the shortfall and provided unsecured debt and equity capital. They worked quickly and provided invaluable assistance in due diligence and deal structure. And they introduced us to various senior lenders from which to choose. Post-transaction, the SBICs gave us flexibility in interest and principal payments allowing us the ability to manage our cash flow properly. The banks would never have been able to offer that level of service or flexibility. In addition, the SBIC later provided additional capital to fund growth.

Most capital that is available to smaller middle market companies brings with it little or no value added services. Typically, a bank parks its money and checks in periodically to track progress. Conversely, the SBICs we worked with brought considerable experience in acquiring, financing and operating businesses in this market segment.

By 1992, the senior lender and the SBIC were paid in full plus interest, and the SBIC have been handsomely rewarded and today are sitting with an annualized internal rate of return of over 30%. Although the SBIC today is a shareholder and has no debt outstanding with Hanger, they continue to sit on our Board of Directors and play an active roll in the affairs of the company.

Few people are aware that, in their youth, companies like Intel, Apple Computer and Federal Express were all financed by SBICs. Since larger funds of capital have all but abandoned the small business, SBIC financing is a more important capital resource than ever before. SBICs function as incubators for expansion-stage businesses like Hanger, and, in doing so, provide a very necessary service to small business across America.

Chairman BOND. Thank you very much, sir.

Now we will turn to Mr. Thompson. Welcome, Ron.

STATEMENT OF RONALD L. THOMPSON, CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER, MIDWEST STAMPING COMPANY, BOWLING GREEN, OHIO

Mr. THOMPSON. Thank you very much, Senator, and thank you to the Committee for allowing me to have this opportunity to address you.

I am Ronald L. Thompson, chairman of the board and chief executive officer of Midwest Stamping Company, a supplier of parts to the original equipment automotive and truck industry. Midwest Stamping is headquartered in Bowling Green, Ohio, with two manufacturing plants in Ohio and one in South Carolina. The company employs over 500 people and supplies assemblers in the United States and exports to Canada and Mexico directly. Our parts are installed on vehicles that are exported to over 36 overseas countries.

In 1993, I led the acquisition of Midwest Stamping Company from its then owners. The acquisition required an investment of $10 million in common equity. Of that amount, $2.5 million was raised from two SSBICs, TSG Ventures which invested $2 million, and Alliance Enterprises which invested $500,000. This supplemented $6 million in equity invested by individuals, including myself, and $1.5 million in additional institutional equity. The total size of the debt and equity financing that was required to complete the acquisition was $90 million.

The process of completing a transaction like this took a great deal of time and energy. The financing required over 3.5 man-years of effort on the part of my staff and our advisers. However, the time spent with the two SSBICs was considerably less. Because of the sophistication and the understanding of their staffs, the fact that they were aware of our company, our business plans, our operations and goals, we were able to complete their investment in less than one man-month of effort, and less than 30 days of actual clock time.

I believe that had the SSBIC industry not been available to me, it is highly unlikely that I would have been able to complete this acquisition.

As Mr. Manganiello just stated, SSBICs and their SBIC partners are not just passive investors in transactions. In our instance, they were involved in every step of the acquisition, providing credibility with the sellers that helped to position us as bona fide purchasers. They provided assurance to our sources of senior and subordinated debt of our ability to complete the transaction, and were very instrumental in documenting the transaction. Their help went well beyond the investments that they made in common equity.

Since closing on the acquisition in March 1993, Midwest Stamping has made significant progress. We have created in excess of 180 new manufacturing jobs with over $5 million in additional annual payroll expenditures. These new jobs account for fully one third of the total of $4.6 million in annual payroll and personal income taxes paid by Midwest Stamping and its employees to Federal, State and local agencies.

Midwest Stamping alone has paid in excess of $5 million in Federal and State corporate income taxes in the 2.5 years since the acquisition, as well. We pay an additional $350,000 in property taxes and contribute in excess of $30,000 annually in support of educational programs. Thus, Midwest and its employees pay directly in excess of $7 million in annual taxes to all taxing agencies.

Since the time of the acquisition, Midwest Stamping has increased its purchases from suppliers by $15 million to an annual total in excess of $70 million. Thus, it can be concluded that the equity investment made by the SSBICs in Midwest has contributed to the significant economic impact that the company is making.

I would like to take up your offer to provide a few comments on my beliefs and recommendations of what can be done to improve the SBIC program. First of all, I fully support the program and encourage Congress to continue its support of it. I believe that the program can be strengthened by expanding the funding available to SBICs and SSBICs. There are still too many regions of the country, including parenthetically Missouri, where SSBIC and SBIC presence is sorely lacking. By directing the SBA to encourage the creation of SBICs in regions underserved, the Congress can help the continued growth of the small business sector of the economy.

I also support the concept of providing funding to the SBIC industry through incentives in the tax code, as compared to the current practice of below market rate direct investments. Providing incentives through the tax code would properly limit the incentives to only those SBICs which generate profits. If they are unable to generate profits through sound investments, I doubt very seriously if the Nation is well served by the Congress providing subsidies to them.

I also support efforts that would streamline the SBA approval and administrative processes. These improvements would reduce the cost of operations experienced by SBICs, which must currently be passed along to the small businesses in which they invest.

Given the poor historical performance of regular SBICs in providing financing to underserved communities and racial minorities, it is imperative that Congress continue to provide incentives to serve these underserved populations. Such incentives could be provided, in my belief, in an overall context in which the SBIC program ceased to be differentiated from the SSBIC program. Thus, institutions would not be forced to choose to finance solely those who qualify as minorities, as the present SSBIC regulations require to provide the additional incentive.

If capital gains taxation at a lower rate was the method of incentivization, the treatment might be limited to only the proportion of the overall portfolio invested in historically underserved communities, thus allowing both SBICs and SSBICs to make loans to those communities with equal treatment. It would have the benefit further of eliminating the stigma that is historically associated with the SSBICs and their portfolio companies.

I believe it is imperative that the Congress continue its support of the small business community and of the important area of capital formation. I applaud your efforts, Mr. Chairman, to ensure that the support continues.

Thank you very much.

[The prepared statement of Mr. Thompson follows:]

Ronald L. Thompson
Chairman and Chief Executive Officer
Midwest Stamping Company

Good morning, I am Ronald L. Thompson, Chairman of the Board and Chief Executive Officer of Midwest Stamping Company, a supplier of parts to the original equipment automotive and truck industry. Midwest Stamping Company is headquartered in Bowling Green , Ohio with two manufacturing plants in Ohio and one in South Carolina. The company employs over five hundred people and supplies assemblers in the United States and exports to Canada and Mexico directly. Parts manufactured by Midwest are installed on vehicles that are exported to over thirty-six overseas countries.

In 1993, I led the acquisition of Midwest Stamping Company from its then owners. The $10 million in common equity required for this acquisition was provided in part from two SSBICs, TSG Ventures which invested $2 million, and Alliance Enterprises which invested $500, 000. This supplemented $6 million in equity invested by individuals including myself and $1.5 million in additional institutional equity. The total size of the debt and equity financing that was required to complete the acquisition was $90 million.

The overall time required to identify , negotiate, and close on the financing of the Midwest acquisition was six months. The financing required over 3.5 man years of efforts on the part of my staff and advisors to complete. The time spent on the common equity portion of the overall financing was considerably less than that spent on the senior and subordinated debt financing. Because TSG Ventures had participated with us in a previous financing and was well familiarized with our business plans and financing needs, it was able to commit to participate in the financing within thirty days. Principals in TSG Ventures introduced the transaction to Alliance Enterprises which promptly reached its commitment to the financing. Due in large part to the sophisticated understanding of the management teams of these SSBICs, less that one man month of effort was required to negotiate, document, and close upon their participation in the equity financing.

The availability of equity from our SSBIC partners was a critical ingredient in the successful acquisition of Midwest Stamping Company. They provided credibility with the sellers that helped to position us as bona fide purchasers, gave assurance to the sources of senior and subordinated debt of our ability to complete the transaction, and were instrumental in documenting the transaction. Their help went well beyond the investments that they made in the common equity. Had they not been involved it is questionable whether the transaction would have been completed. Several other sources of equity financing not affiliated with the SBIC program were contacted as part of our efforts to secure the required financing. The responses from these institutional sources was, generally, that the transaction was too small and the automotive metal stamping industry too fragmented to warrant their investment in it. Several of these potential investors were not willing to make less than controlling interest investments.

Since closing on the acquisition on March 23, 1993, Midwest Stamping has made significant progress. The organization has created one hundred eighty new manufacturing jobs with over $5

million in additional annual payroll expenditures. These new jobs account for one third of the total of $4.6 million in annual payroll and income taxes paid by Midwest Stamping and its employees to Federal, State, and Local agencies.Midwest Stamping has paid in excess of $5 million in Federal and State income taxes in the two and one half years since the acquisition as well. Midwest pays $350,000 in property taxes and contributes $30,000 annually in support of educational programs. Thus Midwest and its employees pay directly in excess of $7 million in annual taxes to all taxing agencies. Since the time of the acquisition, Midwest has increased its purchases from suppliers by $15 million, to an annual total in excess of $70 million. Thus it can be concluded that the equity investment made by the SSBICs in Midwest Stamping Company has contributed to the significant economic impact that the Company is making .

I support the SBIC Program and encourage Congress to continue its support of it. I believe that the program can be strengthened by expanding the funding available to SBICs and SSBICs. There are still too many regions of the country where SSBIC and SBIC presence is lacking. By directing the SBA to encourage the creation of SBICs in regions under served, the Congress can help the continued growth of the small business sector of the economy.

I also support the concept of providing funding to the SBIC industry through incentives in the tax code as compared to below market rate direct investments. This would properly limit the incentive to those who profit by financing small businesses which succeed and would not subsidize those organizations which are not making sound investment decisions. I support efforts that would streamline the SBA approval and administrative processes. These improvements will reduce the cost of operations experienced by SBICs which must currently be passed along to the small businesses in which they invest.

Given the poor historical performance of regular SBICs in providing financing to racial minorities, it is imperative that the Congress continue to provide incentives to serving minority entrepreneurs. Such incentives could be provided in an overall context in which the SBIC Program ceased to be differentiated from the SSBIC Program. Thus institutions would not be forced to choose to finance soley those who qualify as minorities to receive the provided incentive. If capital gains taxation at a lower rate was the method of incentive adopted, the treatment might be limited to only the proportion of the overall portfolio invested in historically under served communities. This would have the benefit of encouraging all SBICs to consider investments in such communities and would eliminate the stigma that has persisted regarding SSBICs and their portfolio companies.

It is imperative that the Congress continue its support of the nations small business sector by responding to the capital formation needs of these enterprises. It should evidence this support through ways that streamline the capital formation process, that extend access to under served communities, and that limit bureaucratic cost and inefficiency.

Thank you for the opportunity to appear before you and to present my views to you.

Chairman BOND. Thank you very much, Mr. Thompson. I guess I need not point out that one of our problems here is that when we are talking about changing the tax code, we have to pick up and go talk to the Finance Committee. I am told that they have a few items on their plate that are going to keep them rather busy this year.

I am interested, though, in your suggestion that there be more incentives or more encouragement to SBICs to perform work that is now traditionally allocated to the SSBICs. Do you think it is possible to achieve that through our existing SBA programs? Are there changes that could be made in the existing programs that would encourage more lending to disadvantaged areas by the SBICs?

Mr. THOMPSON. I believe as long as the method that is currently employed of subsidized direct investments continues that it is possible to say to an SBIC, we will provide some additional subsidization of rate for only that proportion of your portfolio that is invested in these targeted communities. I think that would have the same affect.

It does, of course, still provide the subsidization before the SBIC has proven that its investment decisionmaking has been successful. That is the one disadvantage.

Chairman BOND. Let me turn to Mr. Johnson. Mr. Thompson mentioned some of the assistance that he received from the SSBICs. Did you require any or did you receive any assistance from the SBIC that assisted you? Did you receive any business counseling or assistance that was particularly important?

Mr. JOHNSON. The biggest thing that Allied did for us was handle it quickly. As Mr. Thompson mentioned, his was done in, I think, 30 days or less. Our meeting with Allied was on March 23, and on May 18, we were able to close the transaction.

Allied did assist us in negotiating with LaSalle National Bank, which used to be Exchange National Bank in Chicago. We were kind of running parallel. We had to close the transaction and get the sub debt in place before LaSalle would sign up, but we were talking with them all along. And they were a great help in that instance.

Chairman BOND. Mr. Manganiello, did you find any particular service beyond the availability of capital? What was the benefit of any business advice or other assistance that you received from working with the SBIC?

Mr. MANGANIELLO. Absolutely; the same as was just described. In addition, in our case, once the SBIC became familiar with our business, after they had made the loan, and my experience was the same, that they acted very, very quickly and really did a lot of due diligence and provided a lot of due diligence work for us for free. It really helped us analyze the business.

But post-transaction, they provided additional capital at three different times to grow the business and acted very, very quickly. The banks had to go through the process as if it was beginning all over again, whereas the SBIC just came right in. They sit on our board. They introduced us to senior lenders, and they actually helped our business, introduced us to people that helped us do business.

Chairman BOND. You mentioned that SBICs provided both acquisition and growth capital for your company. This was a company that had a tremendous record of success, a great cash-flow, just not a lot of collateral. Do you have a sense of whether the SBIC money is more important for corporate growth or corporate acquisitions? What is the role of SBICs in providing money for acquisitions?

Mr. MANGANIELLO. Interestingly enough even today, seven or eight years later, even with our growth and additional cash-flow, we still face the same problem with traditional senior lenders. They will only lend on a formula basis against assets. We are in the service business. As a service company, we have got cash-flow, but we do not have a lot of hard assets.

So today we face exactly the same problem and the SBIC continues to fund our growth, not only in acquisition but in building and providing capital for growth.

Chairman BOND. I was going to turn to the approval by SBA. Mr. Johnson, you mention SBA approval for the process, did you have to get administrative approval or get some clearance from the SBA for the SBIC loan?

Mr. JOHNSON. No, sir, we left that up to Allied. We were running a lot of other races, and we left all that up to Allied.

Chairman BOND. Mr. Thompson, did you have to get SBA——

Mr. THOMPSON. Similarly to Mr. Johnson, the SSBICs were required to receive approval for the transaction, which they did, but that was a process in which we were not involved other than having to provide, as I am sure each of my colleagues had to provide certain information, to the SSBIC, or the SBIC to provide to the SBA.

Chairman BOND. You were talking about a total $90 million package?

Mr. THOMPSON. That is correct.

Chairman BOND. That would seem to be an attractive large package that either a venture capital or a mid-size investment bank would make. What kind of problems did you run into? What was your experience in dealing with them?

Mr. THOMPSON. We certainly approached many of them to try to interest them in the common equity. Our problem is that we were viewed, in spite of the size of this transaction, as still too small. They often are very interested in investing $10, $15, $20 million of equity in a single transaction and they find that it is inefficient for them to consider making investments of $1 million or $2 million in a single transaction.

Moreover, in spite of the fact that the automotive industry is such a vibrant part of our Nation's economy, they look at our portion of it as highly fragmented, very many firms, and they do not like to make investments in a highly fragmented industry. They want to go in an industry with concentration, where they can invest in the market leader, or at worse the No. 2, or three player in the marketplace.

So even though it seems like a large transaction to me, it was not the size of transaction that was of interest to the typical investment banking community or the venture capital firms that we talked to.

Chairman BOND. One of the things I am sure that somebody may suggest is that—I believe that you all in your written testimony indicated that you were able to keep a larger equity share than if you had gone to a conventional venture capital. Does this mean that either the Government or the SBICs are leaving equity on the table? Is this too good a deal?

Mr. THOMPSON. In my opinion, no.

Mr. MANGANIELLO. Too good a deal for the venture capitalists, do you mean? For the SBICs?

Chairman BOND. Yes.

Mr. MANGANIELLO. Well, in this case, it was a very good deal for the SBIC. They were a debenture SBIC, under the old program, so they were not giving any portion or percentage to the Government, other than interest. So in their case, it was a very, very good deal. Their internal rate of return was, still is over 30 percent. They got all their money back in two-and-a-half years, plus 16 percent interest. So they did pretty well. They are now riding with free equity capital.

So in this case, the Government could have done better if it did have a piece of it, yes.

Mr. JOHNSON. In our case, as I mentioned, one other source wanted 80 percent of the company to do the financing, and we were not willing to do that. We ended up with Allied, getting warrants for 60 percent of the Company, which we felt like was a fair deal under the circumstances.

And you have got to understand that not all of their transactions are home runs. Sometimes they strike out, and there has got to be a balance there. We think it was a fair deal and it has been a great relationship between us, Allied and LaSalle over the 5 years.

Chairman BOND. Strange you had to go all the way to Chicago. Was the Southeast in that bad a shape?

Mr. JOHNSON. It was in 1990. There were a lot of banks that were being examined and many companies in our industry were going belly up at that time.

Chairman BOND. Let me thank the panelists. I assure you that we will keep the record open, because there will be an opportunity I am sure, as my other colleagues review the written testimony and submit further questions for the record. We very much appreciate you taking the time to prepare the statements in advance, and also to be here.

If we may impose upon you for further questions, we thank you very much for your testimony. We will excuse you and call the second panel.

I am delighted to welcome the second panel. That panel is composed of Cassandra Pulley, Deputy Administrator of the U.S. Small Business Administration. I see she is joined by Mr. Stillman. Patricia Cloherty, president of Patricof & Company Ventures, Inc., New York, New York, chairman of the National Venture Capital Association and chairman of the SBIC Reinvention Council. And Mr. William F. Dunbar, chairman of the National Association of Small Business Investment Companies, Washington, D.C.

Again, my sincere thanks to all of you for coming forward and I would like to begin with Ms. Pulley, if you would present your testimony please.

STATEMENT OF CASSANDRA M. PULLEY, DEPUTY ADMINISTRATOR, U.S. SMALL BUSINESS ADMINISTRATION, ACCOMPANIED BY ROBERT D. STILLMAN, ASSOCIATE ADMINISTRATOR FOR INVESTMENT

Ms. PULLEY. Good morning, Mr. Chairman and members of the Committee. Thank you for inviting me to appear this morning to talk about two of the Small Business Administration's most important partnerships, the Small Business Investment Company or SBIC program, and the Specialized SBIC program.

Accompanying me is Bob Stillman, associate administrator for investment, who has direct responsibility for this program. Bob is a 38 year veteran of the venture capital and private investment business. When the SBIC program first began in 1958, he was already associated with Payson & Trask, one of the earliest organized venture capital firms.

The mission of the Small Business Administration is to help small businesses get started, stay in business, and grow, with the overall objective of creating jobs and accelerating the growth of the economy. An important way of achieving this goal is by making capital available when private sources alone are not providing it.

To accomplish this, the SBA partners with private capital sources across the full range of financing needs of small businesses. These partnerships provide a variety of financing mechanisms to meet the different needs of small businesses.

In order to increase the availability of equity capital and long-term debt to these companies, SBA offers credit insurance to supplement or leverage the private capital of independent venture capital firms, which it licenses as SBICs. With the SBA guarantee, SBICs can raise additional capital.

Why should SBA be in the venture capital business? For one reason only, to fill gaps in capital available to small businesses.

The chart behind me, from an article in the June 26, 1995, issue of Fortune Magazine, speaks of one of these gaps, "Who Will Feed the Startups?" The article recounts the decline in early stage investments from $1.1 billion in 1987 to $750 million in 1993. An earlier article on "The Forgotten Entrepreneur" by David Gliba of Venture One, a research firm, made the same point. Private venture firms have now consolidated into a few mega-firms, backed by institutional investors, each with over $100 million to invest.

These huge capital pools must focus on large investments, and indeed the average individual investment of these firms is $3 million to $5 million. In contrast, the average investment of an SBIC last year was $750,000, and the average investment of an SSBIC is $110,000. Almost $1 billion was invested by SBICs and SSBICs last year, and they continue to invest in young firms, as graphically shown on the next chart.

Another gap filled by SBICs and SSBICs is in the financing of solid businesses which may not have home run potential for equity. A fine example of this strategy is Sirrom Capital Corporation of Nashville, Tennessee, which raised an additional $25 million of private capital in a public offering earlier this year. By financing with loans coupled with equity rights, Sirrom and other SBICs can make a satisfactory return on investment through a combination of inter-

est on the debt and occasional payoff from the equity right. Neither private venture firms nor banks make this kind of loan.

Private venture capital is concentrated in a few large cities: New York, Chicago, San Francisco, Boston, and Dallas; while SBICs are spread all over the country. During the last year, we have licensed new SBICs in St. Louis, Missouri; Nashville, Tennessee; Kansas City, Kansas; Fargo, North Dakota; Portland, Maine; Portland, Oregon; Charleston, West Virginia; Cincinnati, Ohio; and San Diego, California; all areas which are underserved by private venture firms.

SSBICs, by definition, serve underserved markets by investing only in companies owned by persons who are socially or economically disadvantaged. SSBICs and SBICs provide something more than capital. A key criteria for licensing is their ability and expectation of helping the managements they back, help which the entrepreneurs are willing to accept from an investor who has put its own money and its reputation on the line for the business.

Here are a few facts about the program. There are currently 183 active regular SBICs and 91 specialized SBICs. The 274 firms have private capital of $3.2 billion plus $873 million of SBA guaranteed leverage for a total of $4 billion available.

The program greatly magnifies its appropriation. As evidenced on the next chart, an appropriation of $110,000 provides $1 million of leverage. This leverage is matched by at least $500,000 of private capital, giving the SBIC $1.5 million to invest in small business. With this capital, a small business can borrow another $1 million from its bank, making a total of $2.5 million available from a $110,000 appropriation.

The Small Business Equity Enhancement Act of 1992 made major improvements to the program. In fiscal year 1994, and in 1995 year-to-date, 49 new SBICs have been licensed, with over $700 million of private capital, more than doubling the private capital of leveraged SBICs during the last year.

New licensees are now subjected to rigorous screening for management experience and ability. They are much better capitalized. Excluding bank subsidiaries, private capital in each new licensee averaged $15 million compared with an average of $2.4 million for licensees up through fiscal year 1992. These new licensees will represent over 85 percent of all future demand for SBA guaranteed leverage.

The Committee has asked us to address five specific areas. The first is the prognosis for the SBIC program. If adequately supported, the SBIC program can continue to grow and to provide a much needed source of equity capital and long-term debt for small businesses at minimal cost and risk to U.S. taxpayers. The demand for capital is there, the qualified investors are there, the private capital is there. The uncertainty is whether funding and personnel will be available to support the program.

To find new ways to meet the challenge, SBA appointed an SBIC Reinvention Council, headed by Pat Cloherty, who earlier chaired the Investment Advisory Council which drew the road map for the new program. Ms. Cloherty will summarize the report of the council later on in the hearing. While we are still evaluating these pro-

posals, we certainly applaud their objectives and commend their efforts.

A similar study of the SSBIC program has been undertaken by another independent body, the SSBIC Advisory Council, which expects to make its recommendations within the next month. The Investment Division at SBA is also making a detailed review of each of the regulations governing the SBIC program and SSBIC program to simplify and reduce them to the bare essentials.

The second issue is the impact of funding constraints. Obviously, the smaller the appropriation, the less funds the SBICs can raise to supplement their private capital. And the lower the amount, the less these companies have available for investments and long-term loans to small businesses.

The SBIC Reinvention Council has advocated that the SBIC "credit insurance premium" be paid by the SBICs rather than from appropriations. This is certainly one means of allowing the program to grow to its authorization level.

Additional licensing is severely limited by funding constraints. A new licensee can draw leverage over a 4-year period as it makes new investments. Consequently, licensees added last year will call on our available funding for several more years. We have had to stretch out our licensing process and set priorities for allocating available leverage.

To avoid allocating too much leverage to a large new licensee, we limit debenture leverage to that issued to a maximum of $10 million of private capital. This is a severe limitation for our most recent licensees, such as Stratford Capital of Texas as the company increased its private capital to $45 million.

We have virtually discontinued processing of applications for suitability letters, which help an applicant raise private capital. This has been hard on applicants like EdgeCumbe Capital of Minneapolis. An even greater long-term concern is the uncertainty which has developed as to whether the Government is a reliable partner.

The third issue is other obstacles to meeting demand. SBA is actively participating in the SBIC reinvention working group to explore various ways to meet program responsibilities, including the possibility of using outside contractors for some administrative functions.

The fourth issue is the future of the debenture program. Debenture financing is still the most appropriate match for funding SBICs which do their financing in the form of debt, usually with rights to acquire equity through the exercise of warrants or conversion rights.

In fiscal 1994, 63 percent of the financings by leveraged SBICs were in the form of debt. Of the 49 new licensees issued since the introduction of participating securities, one-third, with over $175 million of private capital, were licensed to use debenture financing. Eighty-five percent of the entire portfolio of 183 regular SBICs and all of the 91 SSBICs are licensed only to use debenture financing.

SBIC loans are used by companies that have used maximum bank borrowings but still have capacity to pay additional interest. It is an important source of financing for sound companies that do

not have a prospect of public equity financing, or who have owners who do not want to sell stock in the company.

The fifth issue is the liquidation procedures and the status of our liquidation portfolio. When an SBIC or an SSBIC fails either because losses have eroded its private capital or because of regulatory violations, SBA takes control and forces liquidations of assets to satisfy SBA guaranteed debt. However, private capital must be lost entirely before SBA guaranteed debt is lost.

SBICs own assets which are not readily marketable, so final liquidation of all assets held by an SBIC often takes a long time. Currently, we have 192 SBICs and SSBICs in liquidation whose outstanding leverage at the time of liquidation totaled $790 million. We expect to collect approximately 55 percent of this amount, and we are confident that we have adequate reserves to cover potential losses.

Legislative changes, regulatory changes and changes in SBA's management of the program, all effected through the public-private partnership, have resulted in an SBIC program stronger than ever before. These changes have also resulted in stronger, better managed, and better capitalized SBICs. The SBIC program, with both debentures and participating securities, is as important to the growth and development of small businesses and job creation as it was at its inception.

The final chart lists a few of the companies that benefited from financings by SBICs. Sun Microsystems, Intel, and Federal Express are companies who, in the early stages of their growth, benefited from this most important public-private partnership.

This concludes my testimony, and I will be happy to answer any questions. Thank you.

[The prepared statement and attachments of Ms. Pulley follow:]

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

Cassandra M. Pulley
Deputy Administrator
U.S. Small Business Administration

Good morning, Mr.Chairman and Members of the Committee. I want to thank you for inviting me to appear before you this morning to review the Small Business Investment Company (SBIC) and Specialized SBIC (SSBIC) Program. Accompanying me is Robert D. Stillman, Associate Administrator for Investment, who has direct responsibility for this program. He is a 38 year veteran of the venture capital and private investment business. When the SBIC program first began in 1958 he was already associated with Payson & Trask, one of the earliest organized venture capital firms.

The mission of the Small Business Administration (SBA) is to help small businesses get started, stay in business and grow with the overall objective of creating jobs and accelerating the growth of the economy. An important way of achieving this goal is by making capital available where private sources alone are not providing it. To accomplish this, the SBA is a partner with private capital sources across the full range of financing needs of small businesses. This partnership provides a variety of financing mechanisms to meet the different needs of small businesses.

To increase the availability of equity capital and long term debt, the SBA supplements, or "leverages" the private capital of independent venture capital firms, which it licenses as Small Business Investment Companies (SBICs). The SBA operates as a credit insurance company, guaranteeing obligations of the licensees so they can raise capital beyond that invested by private sources. The private capital is always totally at risk ahead of the SBA-guaranteed securities.

At present there are 183 active regular SBICs and 91 Specialized SBICs (which invest only in businesses owned and controlled by persons whose ability to compete in the free enterprise system is hampered by social or economic disadvantages). These 274 firms have total private capital of $3.2 billion and $873 million of SBA-guaranteed leverage, broken down as follows:

	Number	Private Capital	Leverage	Total
SBIC	183	$3.03 billion	$596 million	$3.6 billion
SSBIC	91	$194 million	$277 million	$0.5 billion

Because of the aggressive steps that the Congress and the SBA have taken to improve the SBIC program, it exemplifies that "This is not your father's SBA."

ADDITIONAL STREAMLINING

On March 27, the President announced additional comprehensive measures to streamline the SBA, to reduce its cost to the Federal budget, make more capital available to more small businesses, and improve the administration and regulation of the program. To examine the SBIC program and recommend specific changes, the SBA appointed a special SBIC Reinvention Council, chaired by Patricia M. Cloherty, President of Patricof & Co. Ventures, and President of the National Venture Capital Association, which represents the private venture capital industry in the United States. Ms. Cloherty in 1991 and 1992 chaired the SBA's Investment Advisory Council. This earlier council made recommendations which were enacted by Congress in the Small Business Equity Enhancement Act of 1992. The resulting changes to the SBIC program have greatly increased its safety and soundness, and have attracted experienced venture investors into the program, with new private capital which in the last year has more than doubled the private funds in leveraged SBICs.

The SBIC Reinvention Council examined the program with an objective of configuring it to make more capital available to more small businesses, at less cost to the taxpayer. The members of the Reinvention Council, who are listed in the attached Exhibit 1, come from the private sector. They include investors and venture capital investment managers, as well as lawyers and industry experts. Individual members have experience in all aspects of venture capital and government regulation, and share a common bond of accomplishing the goals of the reinvention effort. The Council was supported by a Working Group (listed in Exhibit 2), consisting of representatives from SBA's Investment Division and its Office of Chief Financial Officer, as well as the Congressional Budget Office, and outside consultants with extensive backgrounds in the industry.

The conclusions and recommendations of the Council will be presented by one of the Council members at this hearing. The SBA only recently received this report and, at this time, is not in a position to comment on it. We commend the Council and its related Working Group for diligent and thoughtful effort, and certainly agree with the objectives of its recommendations:

1. To eliminate the need for appropriations by making the program self-funding.
2. To provide for stable, predictable funding which can grow to meet the needs of small businesses for equity and long term debt.
3. To improve administration of the program to reduce its risk and improve service.

REGULATORY REFORM

As part of an Agency-wide effort to streamline and simplify regulations, the SBA's Investment Division which administers the SBIC and SSBIC programs is making a detailed review of each of the regulations governing the SBIC and SSBIC program. Wherever possible, regulations will be eliminated or clarified, to hone them down to

those controls essential to protection of the government's interest, and assurance that program objectives will be realized.

BACKGROUND

Since 1958, the SBA has increased the availability of equity capital and long term debt to many small businesses by supplementing, or "leveraging" the private capital of SBICs. SBICs are private investment companies which are managed by experienced investors and represent significant amounts of private capital. Their sole activity is making debt or equity investments in small businesses, putting their private capital at risk ahead of any funds obtained through SBA.

SBICs fill a gap in available financing sources for small business. Most private venture capital firms are now so large that they are unwilling to make investments of less than several million dollars each. Nationwide, of $34 billion of venture capital under management at the end of 1993, only $2.8 billion, or 8% was in firms with less than $25 million of capital to invest, according to Venture Economics Information Services. Most SBICs are in this size range. Only 11.5% is represented by firms with $25 to $50 million under management, while 62.5% is in funds with over $100 million under management.

SBICs generally are smaller than private investment firms, and therefore make smaller investments. In addition, SBICs are limited by statute and regulation to invest only in small companies. The average individual investment by an SBIC in 1994 was $750,000, compared with a $3 to $5 million average for private venture investment companies. Furthermore, the SBA gives highest priority to license applications from parts of the country that are underserved by venture capital and those that will finance new businesses.

Since the inception of the program, SBICs and SSBICs have invested nearly $12 billion in approximately 77,000 small businesses, including close to $1 billion in fiscal year 1994 alone. Regular SBICs have financed approximately 60,000 small businesses, while SSBICs have financed approximately 17,000 small business concerns.

Some SBICs invest in the equity or other permanent capital of small concerns, while others make long term loans, often coupled with rights to purchase an equity interest. These "lender" SBICs provide capital for businesses which do not offer the "home run" potential of later selling stock to the public, or companies whose owners do not want other shareholders. This type of financing is not available from banks or private venture investors.

The role of the SBA in the program is to determine which SBICs to license, to oversee and regulate those licensees, and to arrange for government-guaranteed financing from private sources to add to their capital. The current cost of the program to the taxpayers is only a small fraction of the leverage provided and is a reserve for future losses, as is customary for any insurance program.

In addition to investing or lending, the SBIC managements add value to the small businesses in which they invest by providing advice and counsel to them.

Entrepreneurs will accept this help, since it comes from people who have their own money and reputations at risk in the business and who have had experience with similar situations in other companies they have backed. A significant criterion for licensing during the past year has been the SBA's assessment of the ability of the proposed SBIC management to offer this kind of support.

A number of major U.S. companies trace their early financing to SBICs, including Apple Computer, Federal Express, and Intel Corporation, and more recently, America On Line, Sun Microsystems, Sybase, Inc., Callaway Golf, and Outback Steak House, as well as thousands of other small concerns throughout the Nation.

Private capital and private management are the foundation of the SBIC program. SBICs are managed by private venture investors, who make all investment decisions within the broad parameters allowed by SBIC Regulations. Private capital is always at risk in its entirety ahead of SBA leverage. Funds for leverage are provided through the public sale of trust certificates, guaranteed as to interest and principal by the SBA.

IMPROVING UPON THE PUBLIC/PRIVATE PARTNERSHIP: THE PARTICIPATING SECURITY

In April 1994, the SBA issued final regulations implementing the provisions of the Small Business Equity Enhancement Act of 1992. These new regulations incorporate the best practices of the private venture capital community, as well as the lessons learned from the past experience of the SBIC program. The result has been an enormous strengthening of the program. This complete overhaul of the program corrected the weaknesses that had led to well publicized problems of the past.

Until April, 1994, all leverage provided by the SBA to SBICs came in the form of loans which were made to them by private lenders, and guaranteed as to payment of principal and interest by the SBA. The SBA arranges these financings in public offerings of guaranteed certificates backed by pools of SBIC debentures which are made quarterly.

For those SBIC licensees which typically make loans, with or without equity features, this debt financing represents a well-matched form of leverage. They are receiving interest income from their loans, which they can apply immediately to the payment of interest they owe. The debt financing, however, is a mismatch for the needs of an SBIC that invests heavily in equity securities, which might increase substantially in value over time, but which do not generate immediate cash for distribution to the SBIC to pay interest or principal.

A major achievement of the new program has been the creation of a second form of leverage, designed specifically for equity investors. The new leverage is called the "participating security," which is used by the SBA to invest in the capital of SBICs. This is "patient capital," which has a return ahead of other investors, and offers the SBA a participation in profits. Actual cash payment of the cost of the leverage, however, is deferred until equity investments have matured and profits have been generated.

As with the debenture program, actual funds used for the purchase of participating securities are borrowed from private investors in periodic offerings in which principal and interest are guaranteed by the SBA.

In response to the new regulations, 49 new SBICs have been licensed in fiscal year 1994 and l995, representing approximately $751 million of private capital. An additional 67 applications are on hand, representing another $1.06 billion, while 30 have been denied or withdrawn. The new licensees meet the tough requirements of the new regulations:

- o All have been carefully screened, especially for quality and experience of management.
- o They have been licensed to use the form of leverage which best matches their investment programs: for those which make loans, and have interest income, the SBA offers the traditional debt leverage. For those making equity investments, the SBA uses the new Participating Security.
- o Individual new SBICs have private capital averaging $15 million each, compared with an average of $2.4 million for those licensed in fiscal year 1992. A larger capital base allows the company to secure stronger management, and to have greater diversification of its investments.

A total of 27 SBICs have been licensed to use the participating security, including 26 of the new licensees and one existing licensee. These 27 licensees have private capital of $461.7 million, or an average of $16 million each.

We have on hand 29 additional applications for SBIC licenses contemplating use of participating securities, including 11 that already have committed private capital of $192 million. The remaining 18 applicants are in various stages of raising their private capital, which is estimated at an additional $300 million.

DEBENTURES: STILL IMPORTANT

The new program has stimulated additional interest in debenture leverage as well. During fiscal year 1994 and 1995 to date, we have licensed 16 new SBICs which will use debentures. Their private capital totals $182 million. The managers and business plans of these licensees have been subjected to the same rigorous review as those which will use participating security, and are of equal quality. As discussed above, debenture financing is very appropriate for an SBIC which will have a stream of interest income with which to pay interest on the debentures.

The purpose of the SBIC program, as set forth in the Small Business Investment Act of 1958 is to provide equity capital and long term debt to small businesses, for their growth, expansion, and modernization. These loans differ from bank debt or other commercial indebtedness, since they provide part of the capital base of a company. Consequently, loans made by SBICs are always long term, frequently subordinated to bank debt, and often carry equity rights, such as warrants to buy common stock.

Given the well publicized problems of some SBICs in the past, and the fact they all used debenture financing (since this was the only form of leverage available) it is

natural to question whether the debenture program should be continued. The problems of the past, however, resulted from weak and inexperienced licensees and faulty provisions of debenture prepayment terms, rather than from the debentures themselves. Debentures are an appropriate form of financing for SBIC loans which are used to finance thousands of businesses which can afford to pay interest and principal, but which do not offer an outstanding potential for equity investment, since an equity investor must look forward to eventually selling the investment, in a public offering or upon sale of the entire company. Often, SBICs loan to businesses in fields which the potential for sale of an equity position is doubtful. Yet these are sound, growing companies, which create employment and tax revenue.

At the present time, 155, or 85% of the 182 regular SBICs, and all 91 SSBICs are licensed to use only debenture leverage. Without debentures, they would no longer have access to SBA-guaranteed funding, and would soon have to discontinue new investing. Only 27 companies, or 15% are licensed to use participating securities, and the statute requires that the proceeds of participating security financing be used only in equity investments. The program would shrink to these 27 companies, which do not have the geographic dispersion of the total 273 SBICs and SSBICs.

IMPACT OF THE NEW LICENSEES

The SBA has tightened its credit and management criteria. Attached as Exhibit 3 is a brief description of each of the new SBICs, with an indication of the experience of each.

Because almost all of the leverage funds in the SBIC program are secured from open market sale of securities guaranteed by the SBA, the taxpayer cost of the subsidy for the program is only that fraction of the amount of leverage which is needed to fund anticipated future losses:

Fiscal Year	Leverage Provided	Taxpayer Appropriation
1994	$278 million	$38.4 million
1995	$371 million	$46.4 million
1996*	$452 million	$57.2 million

*Administration budget

The Administration's fiscal year 1996 budget request of $57.2 million would allow the SBA to provide $452 million of leverage to SBICs and SSBICs. Since leverage is provided proportional to private capital, assuming two-to-one leverage, SBA guaranteed portion would be matched by at least $225 million of private funds, thus making over $675 million available for investment in small businesses. Since SBIC financing is typically equity or subordinate debt, this level of investment should allow

these small companies to borrow at least another $450 million from conventional sources, bringing the total amount added to $1.1 billion.

Thus, the $57.2 million of the budget proposed would support the availability of over $1.1 billion to small businesses to support their growth and development. This is truly an investment program that creates jobs and economic development. This in turn will produce tax revenue well beyond the amount appropriated for the program.

IMPACT OF FUNDING CONSTRAINTS

The Committee has asked how funding constraints impact the ability of the program to meet the needs of SBICs, SSBICs, and small businesses. The SBIC program is essentially a credit insurance activity, in which SBA guarantees the credit of private venture capital firms, allowing them to raise funds through open- market sales of securities arranged by SBA. The amount of credit which can be guaranteed is limited by the insurance premium available, currently in the form of annual subsidy appropriations. As I mentioned previously, the response to the improved program has significantly increased SBIC applications. This increased demand will likely exceed our available resources.

A new licensee will typically draw leverage over a four year period, as it makes new investments. The new licensees we have added this last year will call on our available funding for several more years. Consequently, we have slowed the pace of new licensing accordingly.

An additional long term concern is the uncertainty which has developed as to whether the government is a "reliable partner". The current doubt as to future availability of funding may discourage experienced venture managers and prospective investors from casting their lot with the SBIC program. They are willing to limit investments only to small businesses, as we require, and to be subject to our regulations, only if they have reasonable confidence that SBA will be able to do its part by making it possible for them to supplement their private capital.

AVOIDING THE ABUSES OF THE PAST

The new regulations issued in April 1994, coupled with changes in administrative practices, have addressed the problems in the SBIC program. The new regulations were recommended by the Investment Advisory Council appointed by former Administrator Saiki in 1991, and enabled by the bipartisan Small Business Equity Enhancement Act of 1992. Fifteen major new improvements have been made:

Improved Licensing

- Thorough review of management
- Much higher private capital per licensee
- Required independence of management from ownership for participating securities licensees

Improved Securities
- Participating securities are a proper match for equity investing
- Debenture prepayment terms allow easier refinancing

Improved Regulations
- Portfolios must be valued using SBA-approved portfolio valuation guidelines
- Reasonable interest rate spread allowed on SBIC loans.
- Real estate financing curtailed and controlled

Improved Staffing
- Increased Examinations and oversight

Improved Credit Review
- Leverage now based on careful credit review
- Subordination of SBA-guaranteed debt restricted
- Bankruptcy loophole no longer available to SBICs

Repayment with Distributions
- Repayment of SBA leverage required with investor profit distributions, when using participating securities

LIQUIDATIONS

When an SBIC or SSBIC fails, either because losses have eroded its private capital, or because of regulatory violations, SBA takes control and forces liquidation of assets to satisfy the SBA-guaranteed debt. Private capital is always at risk in its entirety before any loss is incurred by SBA-guaranteed leverage. The company's investment is always subordinate to the SBA investment. However, because these companies, by their nature, own assets which are not readily marketable, final liquidation of all assets held by an SBIC takes time. Consequently, of the $3.4 billion guaranteed by SBA since inception of the program 36 years ago, we have in liquidation 192 SBICs and SSBICs, with outstanding SBA guaranteed leverage totalling $499 million. Of these 192 firms, 94% had private capital of less than the $5 million minimum now generally required.

Approximately $29.6 million of the leverage in liquidation was collected in the eight months ending May 31, 1995, and $6.5 million was written off. Five additional SBICs have been brought into liquidation during Fiscal 1995 to date, with $6.5 million of leverage, and 7 cases were closed. Judgments were secured on almost $8 million of interest receivable, which was added to the leverage outstanding.

We reported on the liquidation portfolio in detail in the comprehensive review of the SBIC program submitted to the Senate and House Small Business Committees on May 15 of this year. **The most significant point made was that past appropriations for the SBIC/SSBIC program have been more than sufficient to provide a loss reserve to cover all losses to date and to pay for all future losses anticipated on SBA-guaranteed leverage committed to date.**

As noted previously, SBA is working with the SBIC Reinvention Council to determine if there are more effective and efficient ways to carry out each of the

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functions of the SBIC program, including liquidation. The option of contracting out part or all of the liquidation function will be evaluated as part of this review.

It is important to recognize, however, that a very substantial part of the liquidation portfolio is already being liquidated outside SBA. Of the total of $499 million of SBA guaranteed leverage in liquidation, $204 million, or 41% is being liquidated by outside contractors ("receiver's agents"), in those cases in which SBA has been appointed receiver by the courts. An additional $38 million, or 8% of the total liquidation portfolio is currently headed toward receivership. In addition to using receiver's agents, the individual receiverships use other services, such as collection agencies, accountants, and attorneys to assist them.

An additional $66 million, or 13% of outstanding leverage in liquidation is held by SBICs and SSBICs which are operating under "self-liquidation" agreements. These are entered into when, in SBA's judgment, maximum recovery will be realized using this method. In these instances, the SBIC operators continue oversee the portfolio pursuant to the terms of the self-liquidation agreement **Self-liquidations together with receiverships, bring to $308 million, or 62% of the total leverage in liquidation being liquidated primarily by others, under SBA supervision.**

An additional $73 million, or 15% of leverage in liquidation, is tied up in bankruptcies, and beyond SBA's control. The foreclosure of bankruptcy protection to SBICs which was enacted by Congress last year closed this loophole.

Another $74 million, or 15%of leverage in liquidation, is represented by assets which have been transferred directly to SBA or to a corporation owned by SBA. We are currently utilizing the federal procurement process to hire outside contractors to sell most of these assets.

Of the remaining 8% of leverage in liquidation, a portion is represented by notes being collected by SBA to satisfy past debts. A portion is involved in litigation, while the remainder are the newest cases which are still under review to determine the appropriate course of action.

THE SSBIC PROGRAM

The SSBIC program provides equity capital and long term loans exclusively to businesses owned and controlled by persons whose participation in the free enterprise system is hampered because of social or economic disadvantages. The SSBICs operate under regulations similar to the regular SBICs. They can apply for all the forms of leverage available to regular SBICs, plus subsidized debentures and 4 percent preferred stock.

Most of the smaller SSBICs are active in ethnic communities, in which they are recognized as significant sources of support to local businesses, such as food stores, laundromats, and dry cleaners. Virtually all of these financings are loans, since there is typically no opportunity for generating an investment return from investor ownership of equity in these concerns.

The larger SSBICs are more likely to provide debt with equity conversion or option features, in larger small businesses. Less often, they acquire a direct equity

interest in these companies. Both of these investment patterns are important to the financing of disadvantaged businesses. The very small, local concerns receiving loans from the smaller SSBICs are often anchors of their communities, providing jobs and a sense of progress along with the products or services they provide. Investments in larger businesses are extremely significant, since studies have repeatedly shown that businesses owned and controlled by persons whose participation in the free enterprise system is hampered by social or economic disadvantages are a major source of economic development and job creation for these communities.

There are 91 SSBICs with $194 million of private capital and $276 million of leverage supplied or guaranteed by the SBA. To examine the program and suggest improvements to better serve its market, the SBA has appointed an SSBIC Advisory Council of leaders in the investment-field, including small business owners, SSBIC managers, and experts from the private sector.

The SSBIC Advisory Council is Chaired by Leslie Brun, a widely respected "gatekeeper" who matches institutional investors with venture capital firms. It is supported by a consulting agreement with Prof. Timothy Bates, author of the landmark "Banking on Black Enterprise." Members of the Council are listed in Exhibit 4.

This Advisory Council is close to concluding a set of recommendations for reinventing the SSBIC program. It is currently awaiting proposals from the National Association of Investment Companies, which represents most SSBICs. These will be as the Advisory Council develops its final recommendations.

ADMINISTRATION

The Division continues to explore ways of improving service at reduced cost, including a study of ways to privatize the portions of the program which are still provided by SBA. The challenge is to develop a private program that can continue to provide equity capital and long term debt to small businesses, yet with a significant reduction or elimination of a Federal budget appropriation.

CONCLUSION

The SBIC program is needed more today than ever. It fills a gap in available financing sources to smaller businesses, since most private venture capital firms are now so large that they are unwilling to make individual investments of less than several million dollars. For 36 years the SBIC program has made equity capital and long term debt available to small businesses throughout the United States. Many companies which are household names received early financing from this source.

In April 1994, the bipartisan efforts of Congress and two Administrations produced a major improvement to the program, which has attracted to it experienced venture investors with private capital resources which are much greater than the SBICs of the past. Without question, the SBICs of the future will be even more

effective in creating jobs and generating economic activity, while producing a much higher net profit for the Federal treasury:

- The SBIC program fills a market dislocation created by the consolidation of private venture capital firms into large units which typically do not make smaller investments, or finance companies with limited potential for large profits from increasing value of their equity. SBICs are smaller, and through equity or long term debt financing serve the smaller, newer company, or solid businesses with limited equity potential. SBA policies give highest priority in licensing and leveraging to those SBICs which target these underserved segments of the economy.
- Well over half the private capital and almost all future leverage demand of leveraged SBICs is represented by new licensees, which have been subjected to rigorous screening. These all have experienced management, and much greater private capital resources than most older licensees.
- Regulations and oversight have been tightened and improved, to increase SBA's ability to identify and deal with problems early enough to avoid loss of SBA-guaranteed leverage.
- Further simplification of regulations is underway, to focus attention on those factors which create safety and soundness, and to eliminate those which divert attention from these key factors.
- The SBIC Reinvention Council has made recommendations which could shift the cost of the program from the taxpayer to the SBICs, and thereby make the program self funding. We applaud the Council's objectives, and are studying its specific recommendations.
- We are assisting the SBIC Reinvention Council in studying alternative methods of administering the SBIC program, to reduce cost and provide the special resources needed for its oversight.

This completes my testimony. I would be pleased to answer any questions you may have.

Exhibit 1

SBIC Reinvention Council

Patricia M. Cloherty, Chair
Patricof & Co. Ventures, Inc.

Leslie A. Brun
Hamilton Lane Advisors

Christopher Lane Davis
Attorney, O'Sullivan Graev & Karabell

Stuart I. Greenbaum
Banking Research Center
J. L. Kellogg Graduate School of Management
Northwestern University

William A. Kirk, Jr.
Reid & Priest

Richard Kogan
Center on Budget and Policy Priorities

James A. Parsons
RFE Capital Partners, L.P.

Exhibit 2

Working Study Group
of the
SBIC Reinvention Council

Saunders Miller, Chairman
Investment Division, SBA

Thomas Cuny
Consultant

Christopher Lane Davis
Attorney, O'Sullivan Graev & Karabell

Gerald Feigen
Consultant

Michael Hearne
Office of the Chief Financial Officer

Marvin Phaup
Special Studies Group, CBO

John Werner
Consultant

SBIC PROGRAM

Exhibit 3

New Licensees FY 1994 and 1995

SBICs Using Participating Security Leverage

AVI Capital, L.P., Los Altos, CA. Private Capital $21.9 million. Participating Securities. Investment focus in information technology start-up companies located principally in California's Silicon Valley and selected areas on the West Coast such as Southern California, Oregon and Washington. Management: Peter Wolken, Barry Weinman, and Brian Grossi are venture capital investors who have over 38 years of combined experience providing approximately $200 million in financings to 160 early stage high technology firms in Silicon Valley.

Anthem Capital, L.P., Baltimore, MD. Private Capital initially $12.6 million; to increase to $20-30 million. Participating Securities. Investment focus in companies with $2-10 million of revenue, plus some earlier stage. Management: William Gust, venture capital investor 16 years (CEO of Chesapeake Ventures, L.P., CEO of Broventure Corp); J.C. Weiss, venture capital investor 10 years (Maryland Venture Capital Trust, Utech Funds); Ed Spiva, 20 years with NationsBank, currently EVP of Baltimore Development Corp.

Aspen Ventures West II, L.P., Los Altos, CA. Private Capital $12.3 million. Participating Securities. Investment focus in early stage investments in software-based information science companies located predominately in California. Management: E. David Crockett, venture capital investor 10 years (3i Ventures, CEO of Dataquest); Thaddeus J. Whalen, venture capital related experience 9 years.

Canaan SBIC, L.P., Rowayton, CT. Private Capital $15. million. Participating Securities. Investment focus in growth/expansion financing. Management: Jim Fitzpatrick, venture capital investor 13 years (GE Venture Capital Corp., & Canaan Org.); Eric Young, venture capital investor 12 years (GE Venture Capital Corp., & Canaan Org.); Gregory Kopchinsky, venture capital investor 4 years.

DFW Capital Partners, L.P., New York, NY. Private Capital $10.0 million. Participating Securities. Investment focus in early stage/high technology. Management: Donald F. Demuth, venture capital investor 13 years (Demuth, Folger & Terhune); Thomas W. Folger, venture capital investor 13 years.

Eos Partners SBIC, L.P., New York, NY. Private Capital $15.0 million. Participating Securities. Investment focus in later stage financing. Management: Steven Friedman and Brian Young both have been venture capital investors for 11 years and both worked at Odyssey Partners, L.P.

Exeter Equity Partners, L.P., New York, NY. Private Capital $13.1 million. Participating Securities. Investment focus in mid to later stage financings. Management: Keith Fox, venture capital investor 13 years.

Furman Selz SBIC, L.P., New York, NY. Private Capital $22.5 million. Participating Securities. Investment focus in later stage, growth and management buyout financings. Management: Brian Friedman, venture capital related experience with Furman Selz Investors, L.P., for ten years. Has a blue ribbon advisory group.

Gateway Ventures, L.P., St. Louis, MO. Private Capital $7.5 million. Participating Securities. Investment focus on early stage to expansion stage and beyond companies in health care/life sciences, telecommunications and information services, and software industries. Management: Principals John McCarthy, Richard Ford, and David Millet have worked at Gateway Venture Associates for 11 years.

KCEP I, L.P., Prairie Village, Kansas. Private Capital $11 million. Participating Securities. Investment focus in start-ups and early stage financings. Management: Paul Henson, former CEO of Sprint; Bill Reisler venture capital related experience of 14 years (Pres. of Center for Business Innovation)

LEG Partners SBIC, L.P., New York, NY. Private Capital $12 million. Participating Securities. Investment focus in media, health care and basic manufacturing companies which are in growth stage of their life cycle and principally located in the Southeast and Mid Atlantic regions of the United States. Management: Lawrence E. Golub, seasoned investment professional with over 10 years of experience as an investment banker and private equity investor (Allen & Company Incorporated, Wasserstein Perella & Co., Inc., and Bankers Trust Company); John Harris, auditing and consulting experience 12 years (Arthur Andersen); Deborah K. Nabvian, investment banking related experience 4 years.

Mercury Capital, L.P., New York, NY. Private Capital $15.0 million. Participating Securities. Investment focus in early later stage financings in basic manufacturing and distribution. Management: David W. Elenowitz, venture capital investor for 10 years.

MidMark Capital, L.P., Chatham, NJ. Private Capital initially $10.0 million; to increase to $30 million. Participating Securities. Investment focus in later stage equity financings in travel, entertainment, lodging or rapidly changing technology. Management: Denis Newman, venture capital investor 40 years (First Boston); Wayne Clevenger, Venture capital investor 15 years (Lexington Investment Company).

Needham Capital SBIC, L.P., New York, NY. Private Capital $7.5 million. Participating securities. Investment focus in post-development stage and management buyout financings in technology and life sciences. Management: George Needham, venture capital related investor 23 years; John Michaelson, venture capital related investor 8 years.

North Atlantic Venture Fund II, L.P., Portland, Maine. Private Capital $17.25 million. Participating securities. This company was licensed in 1994 as Maine Capital, a $5 million debenture issuer. Investment Focus: Primarily later stage securities in Maine and adjacent states. Management: David Coit (previously the manager of an SBIC), Clayton Kyle, both with 20 years of venture investment experience.

North Dakota SBIC, L.P., Fargo, North Dakota. Private capital $5.1 million. Participating securities. Investment focus: primarily equity investments in third or later stage manufacturing and service ventures, in North Dakota and contiguous states. Management: David R. Schroder, 20 years of venture investing experience (incl. current management of another SBIC).

Odyssey Partners SBIC, L.P., New York, NY. Private Capital $45.4 million. Participating securities. Investment focus in middle to late stage venture capital opportunities and middle market buyouts. Management: Stephen Berger, venture capital related investor 8 years; Alain Oberrotman, venture capital investor 4 years; Subsidiary of Odyssey Partners, L.P., a major private venture capital fund.

Pacific Northwest Partners SBIC, L.P., Bellevue, WA. Private Capital $10.6 million. Participating Securities. Investment focus in early stage equity financings in software, health care and specialty retailing companies. Management: Theodore Wight, venture capital investor 14 years (Walden Capital Partners).

Pioneer Ventures Limited Partnership II, Boston, MA. Private Capital, $15.0 million. Participating Securities. Investment focus is split between early and later-stage growth companies in industries throughout the U.S. Management: Frank Polestra, venture capital investor, 15 years (Pioneer Ventures, Pioneer Capital Corp.), C. Walter Dick, venture capital investor, 10 years (Pioneer Ventures,Pioneer Capital Corp., UST Corp.), Christopher Lynch, venture capital investor, 18 years (Pioneer Ventures, Pioneer Capital Corp., Massachusetts Capital Corp., TA Associates), and Leigh Michl, venture capital investor, 5 years (Pioneer Capital Corporation).

Piper Jaffray Healthcare Capital, L.P., Minneapolis, MN. Private Capital $7.5 million. Participating Securities. Investment focus in early and later stage financings in medical devices and health care services. Management: Lloyd Benson, venture capital investor 11 years (Piper Jaffray Funds).

Prospect Street NYC Discovery Fund, L.P., New York City. Private Capital $15 million. Participating securities. Investment focus: start-up, early and middle stage companies, involved with advanced technologies, within the five boroughs of New York City. Management: Richard Omohundro, seven years of venture capital experience and ten years of investment banking experience.

RFE Investment Partners V, L.P., New canaan, CT. Private Capital $35.7 million. Participating Securities. Investment focus in later stage low tech financings. Management: James Parsons, venture capital investor 13 years with both private and SBIC funds; Mark Inglis, venture capital investor 11 years.

River Cities Capital Fund, L.P., Cincinnati, Ohio. Private Capital $11.6 million. Participating Securities. Investment focus in start up and early stage financings in manufacturers, distributors, broadcasting and service companies. Management: R. Glen Mayfield, venture capital related investor 26 years; Edwin T. Robinson, venture capital investor 5 years.

SBIC Partners, L.P., Fort Worth, TX. Private Capital $30 million. Participating Securities. Investment focus in middle to late stage financings. Management: Gregory Forest, venture capital investor 21 years (First SBIC of CA); Jeffrey Brown, venture capital investor 7 years (First SBIC of CA).

Sorrento Growth Partners I. L.P., San Diego, CA. Private Capital $10.8 million. Participating Securities. Investment focus in mid to late stage financings. Management: Robert Jaffe, venture capital investor 9 years; David Titus, venture capital investor 8 years.

Walden-SBIC, L.P., San Francisco, CA. Private Capital $10.0 million. Participating Securities. Investment focus in early stage financings in computer peripherals, software, electronics and health care. Management: Arthur S. Berliner, venture capital investors 20 years (Walden Funds); George S. Sarlo, venture capital investor 20 years (Walden Funds).

Zero Stage Capital V, L.P., Cambridge, MA. Private capital $10.8 million. Participating Securities. Investment focus half in early stage ventures and half in later stage investments. Management: Gordon Baty, venture capital investor 9 years; Paul Kelley, venture capital investor 13 years.

<u>Licensees Using Debenture Leverage</u>

Anker Capital Corp., Charleston, WV. Private Capital $2.5 million. Debentures. Investment focus in expansion financings primarily in West Virginia and surroundings states. Management: Thomas Loehr, venture capital related investor 5 years.

Byrd Business Investment, L.P., Nashville, TN. Private Capital $4.5 million. Debentures. Investment focus in later stage financings. Management: Damon W. Byrd, venture capital investor in his own fund.

Cordova Capital Partners, L.P., Atlanta, GA. Private Capital $27.5 million. Debentures. Investment focus in growth/expansion financing. Management: Paul DiBella, venture capital investor 2 years: Lewis Manderson, Jr., venture capital investor 4 years.

Exeter Venture Lenders, L.P., New York, NY. Private Capital $13.1 million. Debentures. Investment focus in mid to late stage financings. Management: Keith Fox, venture capital investor 13 years.

First Legacy Fund, Inc., Washington, D.C. Private Capital $3 million. Debentures. Investment focus in family owned businesses. Management: Jonathan Ledecky, venture capital investor 11 years.

Hanifen Imhoff Mezzanine Fund, L.P., Denver, CO. Private Capital $14.7 million. Debentures. Investment focus in mezzanine financings. Management: Edward Brown, venture capital investor 20 years; Steven Leatherman, venture capital investor 3 years.

KOCO Capital Company, L.P., Mt. Kisco, NY. Private Capital $5 million. Debentures. Investment focus in later stage financings. Management: James A. Kohlberg, venture capital investor 9 years, and Jerome Kohlberg, formerly of KKR.

Novus Ventures, L.P., Cupertino, CA. Private Capital $5 million. Debentures. Investment focus in the field of information technology, primarily equity investments in early stage companies. Management: Dan Tompkins, high tech venture capital investor and manager with 12 years experience (including two SBICs, one of which was Wells Fargo); Shirley Cerrudo, venture capital investor 20 years (including Wells Fargo).

Pacific Capital, L.P., Brentwood, Tennessee. Private Capital $10 million. SBA Debentures. Investment focus: debt and equity investments in Southeastern U.S. companies generally affiliated with the health care industry. Management: Stephen Wood, Clay Caroland, and Larry Williams, who collectively have experience in lending to the health care industry, investment banking and venture capital, and financial evaluation.

Pacific Mezzanine Fund, L.P., San Francisco, CA. Private Capital $20 million. Debentures. Investment focus in expansion buyout financing. Management: Nathan Bell, venture capital investor 8 years (Prudential Capital Corp.); David Woodward, venture capital investor 6 years (BBU Mezzanine Fund).

Seacoast Capital Partners, L.P., Danvers, MA. Private Capital $30 million. Debentures. Investment focus in mezzanine financings in environmental services. Management: Eben S. Moulton, venture capital investor 10 years (Signal Capital Corporation); Walter H. Leonard, Venture Capital investor 4 years (Signal Capital Corporation).

Shaw Venture Partners III, L.P., Portland, OR. Private Capital $30.1 million. Debentures. Investment focus in start up and early stage financings in several high and low tech industries. Management: Ralph R. Shaw, venture capital investor 11 years; Alan S. Dislip, venture capital investor 7 years.

Shenandoah Venture Capital, L.P., Charleston, WV. Initial Private Capital $ 2.5 million. SBA Debentures. Investment focus: start-up, expansion and turnaround financing, primarily in West Virginia and adjacent states. Management: Thomas E. Loehr, whose firm serves as the manager of two recently licensed West Virginia SBICs.

Stratford Capital Group, Inc., Dallas, TX. Private Capital $5 million. Debentures. Investment focus in later stage financings. Management: Michael Brown, venture capital investor with an SBIC.

Wasatch Venture Corp., Salt Lake City, UT. Private Capital $4.5 million. Debentures. Investment focus in development and expansion financings. Management: Timothy Draper, venture capital investor 9 years (Draper Associates).

WestVen Limited Partnership, Charleston, WV. Private Capital $2.5 million. Debentures. Investment focus in expansion financings primarily in West Virginia. Management: Thomas Loehr, venture capital related investor 5 years.

<u>Bank-Owned Licensees not Seeking Leverage</u>

BancFirst Investment Corp., Oklahoma City, OK. Private Capital $2.5 million. Non-leveraged. Investment focus in late stage financings. Management: T. Kent Faison, Several years of lending experience.

First Commerce Capital, Inc., New Orleans, LA. Private Capital $24 million. Non-leveraged. Investment focus in late stage financings. Management: William J. Harper, venture capital investor 6 years (Westinghouse Financial Services, Inc.).

First Security Business Investment Corporation, Salt Lake City, UT. Private Capital initially $2.5 million; to increase to $5 million. Non-leveraged. Investment focus in late stage financings in manufacturing, wholesale, distribution and service. Management: Louis O. Adler, venture capital related experience with First Security Bank 13 years.

Fleet Equity Partners V, L.P., Providence, RI. Private Capital, $10.0 million. No SBA leverage. Investment focus is balanced between emerging and established small concerns, with debt or equity placements ranging between $1-2 million. Management: Robert Van Degna, venture capital investor, 19 years (Fleet Venture Resources, Inc.) and Habib Gorgi, venture capital investor, 9 years (Fleet Venture Resources, Inc.).

Norwest Equities Partners v, Minneapolis, Minnesota. Private Capital $100 million. No leverage. Investment focus on emerging growth and mature companies in the software, health care, communications, consumer, and manufacturing industries. Management: Principals Daniel Haggerty, George Still and John Lindahl have many years experience at Norwest Venture Capital Management.

UBS Partners, Inc., New York City. Initial Private Capital $2.6 million, with additional equity investment as needed to fund investment demand. This wholly owned subsidiary of the Union Bank of Switzerland will be unleveraged. Investment Focus: Equity and equity-type securities of growth capital or change of ownership transactions, throughout the U.S. Management: Justin Maccarone, Jeffrey Keenan, Michael Green, and Robert Dinerstein, all of whom have extensive experience in venture capital investing, investment banking, and merchant banking.

Exhibit 4

Specialized Small Business Investment Companies (SSBIC) Advisory Council Members

Mr. Leslie A. Brun
Hamilton Lane Advisors

Mr. Chuck Valdes
Chair, Investment Committee
Calpers

Mr. Raymond J. McGuire
Managing Director
Merrill Lynch

Mr. Christopher T. Morris
Savant Group

Mr. Marx L. Cazenave II
Progress Investment Management Company

Ms. Sona Wang, Principal
Inroads Capital Partners, L.P.

Ms. Jeanna M. Cullins, Executive Director
D.C. Retirement Board

Mr. Larry Bailey, Partner
Coopers & Lybrand

Mr. Frank B. Brooks
c/o Spruce Corporation

Mr. Cleveland Christophe
TSG Ventures, Inc.

Ms. Katherine M. Todd, Partner
Brinson Partners, Inc.

Mr. Victor K. Chun, President
Exim Capital Corp.

Laurence C. Morse, Ph.D
Fairview Capital

Mr. Terry L. Jones, President
Syncom Capital Corp.

Mr. Donald R. Lawhorne, President
MESBIC Ventures, Inc.

Mr. Bruce Gamble
President
National Association of
Investment Companies

Mr. Jerry Feigen
Consultant

Timothy Bates, Ph.D
Wayne State University

ACCESS TO CAPITAL

SBA

JUNE 26, 1995 VOL. 131, NO. 12

FORTUNE

WHO WILL

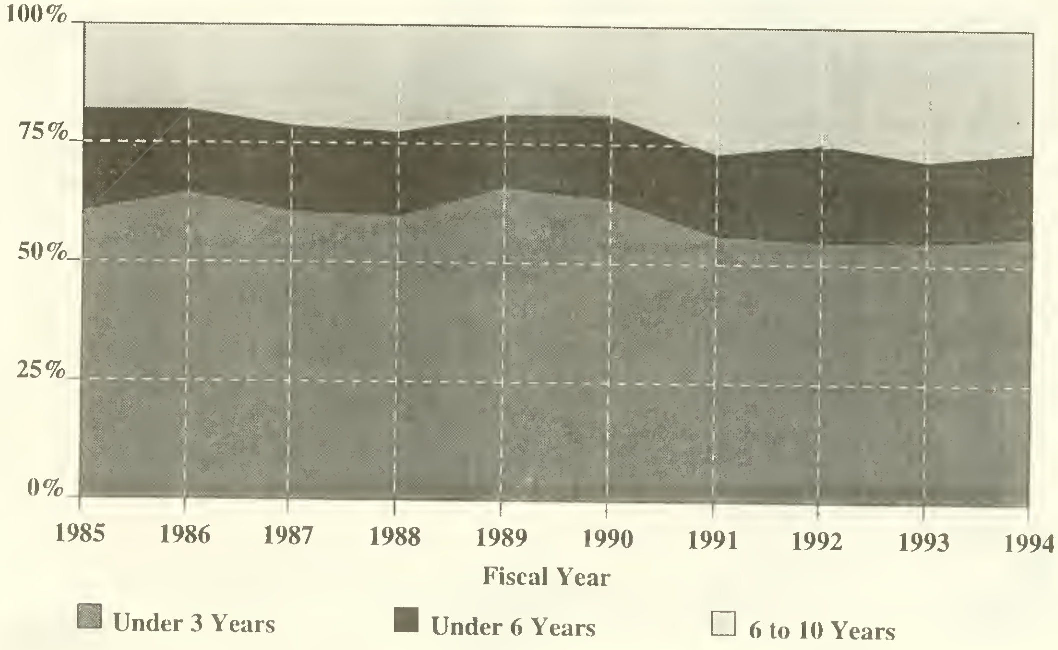
feed

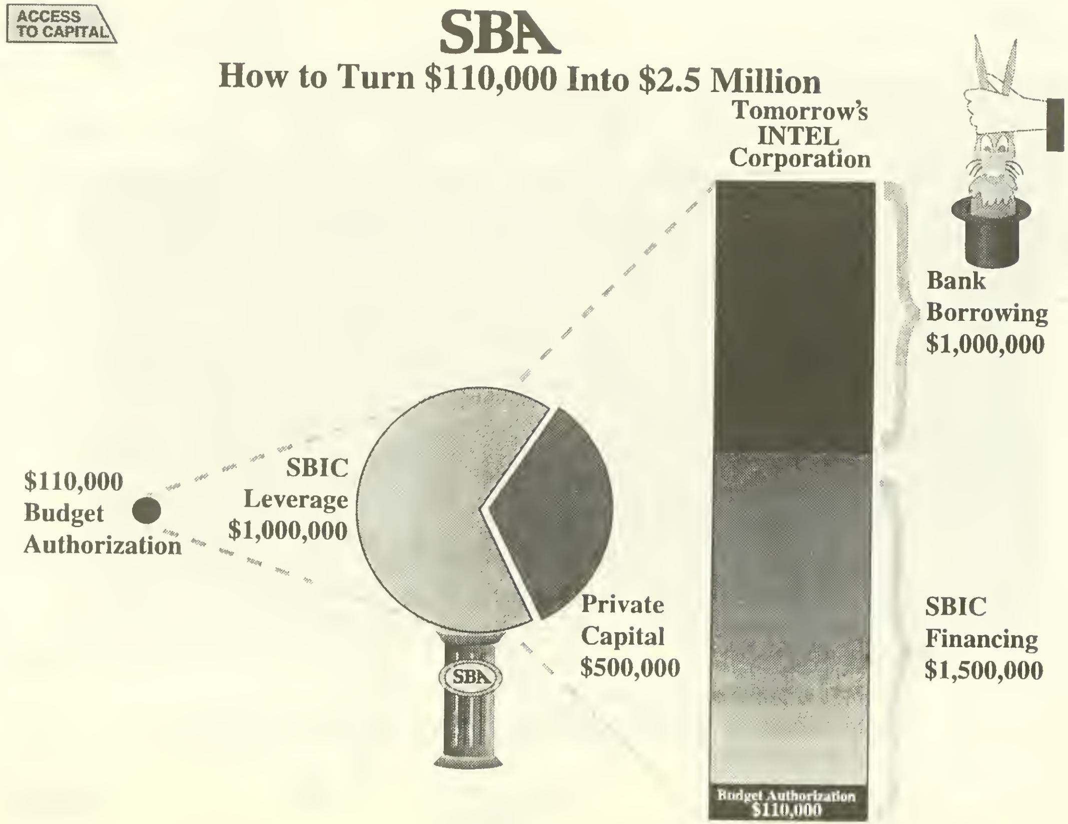
THE STARTUPS?

ACCESS TO CAPITAL

SBA

SBIC Program Financing to Young Companies
(% of Dollars Disbursed to Small Businesses)




ACCESS TO CAPITAL
SBA
How to Turn $110,000 Into $2.5 Million
Tomorrow's INTEL Corporation
Bank Borrowing $1,000,000
SBIC Financing $1,500,000
Budget Authorization $110,000
$110,000 Budget Authorization
SBIC Leverage $1,000,000
Private Capital $500,000
SBA

ACCESS TO CAPITAL

SBA Today's SBIC

	Before (FY 1992)	After (FY 1994)
Financing of Small Companies	$449 million	**$948 million**
New Private Capital Licensed	$24 million	**$520 million**
Private Capital per New Licensee*	$2.4 million	**$15 million**
Cost to Taxpayer	$12 million	**$34 million**
SBA Leverage	debt instrument only	**flexible debt or equity instrument**

*excluding bank subsidiaries

ACCESS TO CAPITAL

SBA

Publically Traded U.S. Companies that Received Financing through the SBIC Program

FEDERAL EXPRESS

Petstuff, Inc.

intel®

CRAY RESEARCH

OUTBACK

GYMBOREE CORP.

sun microsystems

Sybase, Inc.

Apple

Callaway GOLF

AMERICA Online

Envirotest Systems

Watson Laboratories, Inc.

Chairman BOND. Thank you very much, Ms. Pulley.
Ms. Cloherty.

STATEMENT OF PATRICIA M. CLOHERTY, PRESIDENT, PATRICOF & CO. VENTURES, INC., NEW YORK, NEW YORK

Ms. CLOHERTY. Thank you, Mr. Chairman. I am pleased to be here to discuss this important subject, although I must say I would rather be doing a deal.

I come to these hearings from the private non-SBIC venture capital industry. My own firm, Patricof & Co., of which I was a founding member almost 26 years ago, started with $2.5 million under management which we thought was really terrific. It was all from wealthy families. Today we have increased that to approximately $2 billion under management here and in Europe. In the U.S. we have approximately $785 million under active management, and the balance is in five countries of Western Europe.

All of our sources of capital today are institutional fiduciaries, mainly public and private pension funds. We closed on a new fund on February 20, of $265 million, which we are now investing.

My firm's growth and change constitute a microcosm of the growth and change of the entire industry. Our capital under management has increased. Our average deal size has increased. We have broadened geographical scope. I mentioned the international aspect. And our sources of capital have changed profoundly from individuals to wealthy institutions, so every 5 years we grovel for new capital. The groveling remains unchanged.

Also, like many firms in the industry, we once owned an SBIC. We formed it in the mid–1970s, 1976 to be precise, it was licensed and capitalized again by wealthy families and individuals. Although the license ultimately was surrendered at the end of the partnership period involved, the SBIC was in fact the basic building block of our business today. It was that, particularly in the capital market conditions in the 1970s, it was that without which we would not have been able to raise capital, nor to achieve the performance record that enabled us to stay in business and to grow.

I will interject one thing here, just so everyone in the room understands that venture people, including SBICs, privately owned SBICs that are equity oriented, compete with one another on the basis of internal rates of return. We have to beat the real pre-tax returns on U.S. Treasuries over the life of the partnership by a factor of three to five or indices of marketable securities by several hundred basis points in order to stay in business. So that, since our firm never loans, we do go for growth in every instance.

Against this background of the private business, and having chaired the SBIC Reinvention Council which just completed its work, I would like to comment here briefly in three areas. One, on the rationale for the SBIC program, which is the subject of current discussion. I would like to talk a bit about its current problems and prospects.

Finally, I will summarize the recommendations of the Reinvention Council. On the program rationale, what public policy purpose does the SBIC program perform and why does not the private sector do it all? I have the view, having been around this track for almost 30 years, that the SBIC program is unique world-wise

in the annals of any Government program having anything to do with economic growth. The field of economic growth internationally is a cemetery of failed projects.

The SBIC program, by contrast, in my mind, has been extremely effective because, one, it is founded on private capital. Second, it utilizes private investment disciplines. And finally, for those reasons, it works. Even before the much needed financial restructuring of the program, effected through legislation in 1992, the benefits of the program far outweighed the cost, which I think is analytically demonstrable, as shown in this report that was submitted in 1992, that contains a financial analysis of the program since inception.

I would like to elucidate the unique elements that I think, in my mind, serve public policy purposes. First of all, the SBICs do provide risk capital, which the previous panel of entrepreneurs discussed. Virtually all enterprise development programs anywhere in the world are based exclusively on debt forms of financing that are especially unsuitable to growth oriented early stage companies that yield national economic growth.

The SBIC program uniquely provides both permanent equity capital and long-term debt capital to small enterprises when they need them both.

Second, the capital employed by the SBICs and indeed in the private venture business is small but highly productive. The entire program, even with the entire private venture capital business in the U.S. thrown in, is tiny. It is infinitesimal relative to aggregate capital markets, equity or debt. But it is the most productive form of investment, in terms of jobs, wealth and yes, tax base created per unit of capital invested.

Third, SBICs provide vehicles for harnessing small amounts of private capital to fuel enterprise growth. In the 1950s, when this was formed, it was seen as middle class venture capital, for doctors and dentists and other professionals. It pulls private capital out of the mattress and puts it to work at risk for growth.

Individual investors today have nowhere to go today to do that. The financial landscape of today does not offer an opportunity for individuals to put small amounts of their available wealth at work under professional management. Money market mutual funds simply do not do it.

SBICs invest in small, more geographically diverse, enterprises compared to the private venture capital industry. In our own industry (I have been president and now chairman of the National Venture Capital Association), approximately two-thirds of the capital of our industry is invested in two areas of the country, specifically the Northeast and the West, mainly California. That pattern has been true 1992, 1993, and 1994 and characterized the entire previous decade.

Fifth, SBICs provide a flow of seasoned risk capital managers. Having worked in many countries over many years, I believe that this is the overwhelmingly important public policy purpose of the program. The skill involved in marshaling and deploying risk capital for growth is unique in the U.S. When we pioneered in Europe, we had to hire people from consulting firms. There were no risk managers. They were not entrepreneurial societies and they did not

have that talent available. I think that talent is the envy of countries who are seeking to harness capital and talent for growth.

As a subset of that issue, SBICs offer opportunities for younger, otherwise skilled, investment personnel to raise first-time funds, a task that is virtually impossible in the private market today. Only older people, like me and my partners, can raise money.

The Equity Enhancement Act of 1992 did breath life into the program and Cassandra Pulley mentioned the progress of the program since those reforms, and the fact that over $700 million in private capital has been committed.

This momentum is being stopped dead in its tracks today by two main factors. One is uncertainty over availability of Government capital. Second, there is uncertainty as to its availability at the time and in the amount required.

Specifically the venture business has gone to just-in-time financing. We call down cash as we need it, in order not to create a drag on returns by having to manage cash. So just-in-time funding was built into the new program.

Over and above those issues, there are regulatory issues, program management issues that in my mind can be sorted out among reasonable people, but these pale relative to the capital commitment issues.

Approach recommended by the Reinvention Council. We did submit a report and these were all circulated to you all, of the Reinvention Council. I should note that we explored but did not embrace the immediate privatization of the program in the form of a Government-sponsored enterprise, which is the approach that my colleague to my left will present on behalf of NASBIC.

I should say that the Council agrees completely on ultimate objectives with NASBIC, the trade association. However, for purely judgmental reasons, we thought that a more gradualist approach of retaining the program within Government for a period of time until it "gets legs," that is, until it shows its economic viability, would be appropriate and doable, to then spin it out in a way that inspires confidence.

The Council made five recommendations designed to eliminate all Federal costs. Let me summarize briefly, because you have them all. It is a combination of basically four elements, increases in fees, increases in examination expenses, increases in profit participation under the new participating preferred instrument, and a change in the form of funding of the program from sale of securities in the capital markets to going back to the pre-1986 form of Government direct provision of capital. That creates all of the savings and creates what, in effect, becomes a negative subsidy rate which in Government I understand means that the number is positive.

In any event, our report estimates at various levels of those steps the kinds of savings that one can achieve and, in fact, bring the program into being totally self-supporting.

We also have recommended over time that the loss rates assumptions used by OMB in computing the subsidy rates be reexamined and brought into alignment with the empirically-generated reality in both the debenture and the participating preferred instrument.

A couple of more comments and I will end. We had a sixth recommendation related to the specialized SBICs. Our committee did

not deliberate those. They are attached as a supplement to our report. As Ms. Pulley mentioned, the separate advisory group will be fully deliberating those and submitting separate recommendations.

Finally, your letter to me asked that we comment on the liquidation issue. On behalf of my council, I will say that we did not review the portfolio in liquidation, so it is very difficult to comment knowledgeably.

On the other hand, as a general rule, when you are liquifying anything, particularly in the equity end of the business, there is a premium on speed. The faster you move, the more of the asset values you are apt to recover. It does occur to me that there is an iceberg aspect to the total amount in liquidation at the Agency. It should move a little more quickly I would think.

Finally, should the debenture program continue? I have to say I would agree with the previous panel, absolutely yes. It is very difficult to get small loans, particularly ones that are not fully collateralized. In my view, the current consolidation of the banking industry that is underway in the United States will make it harder and not easier for small businesses to participate in the flow of loans.

In conclusion, in my view we are here discussing a unique program with a 30-year track record of effective financings of and management assistance to entrepreneurial business across the U.S. In the absence of such a vehicle, I think it will be difficult for small businesses to get the small amounts required to launch or to grow.

Our council offered a very modest set of proposals to reasonably meet very real budget constraints at the Federal level, while keeping a worthwhile program moving ahead at a critical and promising juncture in its history. We welcome the open forum for discussions, for questions, and hopefully for early resolution.

Thank you.

[The prepared statement of Ms. Cloherty follows:]

U.S. SENATE
COMMITTEE ON SMALL BUSINESS
RUSSELL SENATE OFFICE BUILDING, 428A
JULY 13, 1995, 9:30 A.M.

STATEMENT BY PATRICIA M. CLOHERTY
PRESIDENT, PATRICOF & CO. VENTURES, INC.
CHAIRMAN, NATIONAL VENTURE CAPITAL ASSOCIATION
CHAIRMAN, SBIC REINVENTION COUNCIL

Introduction

Mr. Chairman and Members of the Committee. I'm pleased to be here to discuss issues relating to SBA's Small Business Investment Company (SBIC) program, and I thank you for inviting me.

As you may know, I come to these hearings from the private, non-SBIC, venture capital industry. My own firm, Patricof & Co. Ventures, was started 25 years ago, with $2.5 million in private equity capital under management, all from wealthy individuals. Today, we have approximately $2.0 billion under management in the U.S. and in five European countries, with capital from institutional investors, mainly public and private pension funds.

The growth and change in my own firm reflects in microcosm the growth and change that characterizes the industry as a whole over the period: increased funds under management, increased average size of deals, broadened geographical scope, and a change in the sources of capital from individuals to large institutional fiduciaries. Also, like many of the leading firms in the business today, we once owned an SBIC, formed in the mid-70's, capitalized by wealthy individuals. Though the license ultimately was surrendered at the end of the partnership period, the SBIC was the basic building block of our business today. It was that without which we would not have been able to raise the capital nor achieve the performance that enabled us to stay in business and grow.

Against this background, and with the work of the SBIC Reinvention Council, which I chaired, just completed, I'd like to comment here briefly in three areas: 1) the rationale for the SBIC program; 2) its current problems and prospects; and 3) the recommendations of the Reinvention Council.

Program Rationale

The SBIC program is unique, world-wide, in the annals of government programs having anything to do with economic growth, mainly because it is founded on private capital and private investment disciplines, and because it works.

Even before much-needed financial restructuring of the program effected through legislation in 1992, the benefits of the program far outweighed the cost to the government. These costs and benefits were spelled out in detail in the report of the Investment Advisory Council dated February, 1992, entitled Financing Entrepreneurial Business: An Agenda for Action.

Let me elucidate the unique elements that serve important public policy purposes.

1) SBIC's provide risk capital. Virtually all enterprise development programs anywhere in the world are based exclusively on debt forms of financing that are especially unsuitable to growth-oriented, early-stage companies. The SBIC program uniquely provides both permanent equity capital and long-term debt capital to small enterprises when they need it most.

2) The capital employed is small but highly productive. The entire program, even with the private venture business thrown in, is tiny -- infinitesimal relative to aggregate capital markets. But it is the most productive form of investment in terms of jobs, wealth and tax base created per dollar of investment.

3) SBIC's provide vehicles for harnessing small amounts of private capital to fuel enterprise growth. Few such vehicles exist in today's financial landscape. Individual investors, in particular, have nowhere to go in putting small amounts of capital under professional venture managers for risk in smaller enterprises.

4) SBIC's invest in small, more geographically diverse enterprises, compared to the private venture capital industry. For the period 1986 through 1990, more than two-thirds of private venture capital was deployed in the Northeast and West (mainly California) compared to 30% for SBIC's, which invested broadly across all regions. Statistics for 1992-1994 for private ventures show similar concentration.

5) SBIC's provide a flow of seasoned risk capital managers. Having worked in private equity investing in several countries, I believe that this is the overwhelmingly important public policy purpose of the program. The skill involved in marshalling and deploying risk capital for growth is unique to the U.S. still. It is the critical stimulant to entrepreneurship, carried out in a systematic fashion. And, frankly, the talent base is the envy of those countries who are seeking some way to harness capital and talent for growth. As a subset of this, the SBIC's offer opportunities for younger, otherwise skilled venture investors who today face a virtually impossible task when raising capital for their own first-time funds.

Current Problems and Prospects of the Program

The Small Business Equity Enhancement Act of 1992, which made a participating preferred security available to SBIC owners and investors, breathed new life into the program and set the stage both for new equity fund formation and for new capital flows to entrepreneurial business. This new life is reflected in the increased licensing activity and commitment of more than $700 million in private capital in the past two years.

The positive momentum is being stopped in its tracks currently by two central factors: uncertainty over availability of capital generally; and uncertainty as to availability of capital in the amount and at the time it is required. (N.B. The private equity business has moved in recent years to just-in-time funding, so that venture managers do not sit with idle, undeployed cash, but rather, they are able to call cash down as needed over the average five-year investment cycle in a 10-year partnership. This enhances overall returns substantially and leaves cash where is managed best. The new SBIC program was designed to accommodate this critical practice.)

Over and above funding issues, there are assorted regulatory and program management issues to be sorted out. But these pale in significance to the Big Two issues of government's signalling its commitment to proceed by a) committing requisite capital, and b) committing it timely.

Approach Recommended by the SBIC Reinvention Council

The recommendations of the SBIC Reinvention Council, contained in a report dated June 23, 1995, have been circulated to you.

The Council reviewed the public policy purpose of the program and its current status. In the light of that fact-finding, the Council sought an approach to the program that would cause it to work better, at reduced cost to the government, in a way that had greater likelihood of being implemented near-term.

I should note that the Council explored, but did not embrace, total immediate privatization of the program in the form of a Government-Sponsored Enterprise (GSE), the approach favored by NASBIC. The reason was purely judgmental: we thought it would not be achievable near-term, though the Council agrees completely with NASBIC on the overall objectives.

Instead, we adopted the more gradualist approach of retaining the program within SBA now in order to gain additional experience with the program, especially with the new participating preferred and with the beefed-up licensing procedures, to see empirically if the program can be self-financing as we believe, in order to spin it out later, with a demonstrated track record.

The Council made five recommendations designed to eliminate all federal costs of the SBIC program, with implementation commencing immediately in FY 96, as follows:

1. <u>Increase user fees</u>.

Immediately seek Congressional approval of statutory changes, as necessary, to increase credit user fees for SBIC securities, and to apply the proceeds of these fees to reduce the Federal cost of the SBIC program (i.e., the subsidy rates for these securities):

a. SBIC Debentures:

(1) Increase the initial fee for additional leverage by 1%, bringing it to a total of 3%, payable when insured credit is made available to a licensee.

(2) Increase the interest rate charged to licensees by up to 200 basis points over the public funding cost (e.g., if the public financing was at 7.2%, the licensee would pay 9.2%), with the additional proceeds being passed through the Federal government.

b. Participating Securities:

(1) Increase the initial fee for insured credit by 1%, bringing it to a total of 3%, payable when credit is made available to a licensee.

(2) Increase the prioritized payment rate charged to licensees by up to 200 basis points over the public funding cost (e.g. if public funding were at 7.2%, the prioritized payments would be 9.2%) with the additional proceeds passed through to the Federal government.

(3) Increase SBA profit participation from the current rate of 9% at one "tier" of insured credit to 11%, and from 12% at two "tiers" of insured credit to 14%.

Based on discussions of Investment Division personnel with a representative group of licensees at three separate regional SBIC meetings in recent weeks, the Council believes that licensees would be willing to pay the higher fees if they have greater assurance of consistent and adequate funding.

Assuming an annual program level of $400 million for participating securities and $200 million for SBIC debentures, the Council's Working Group calculates that (subject to OMB concurrence) these changes would reduce the

subsidy rate on participating securities to minus 1.9%, (i.e. a net income) and on debentures to 2.5%. Congressional authorization should be sought for cross-subsidization of the SBIC debentures and participating securities (i.e. offsetting the cost of the debentures with the net income of the participating securities). Subject to OMB concurrence, the Council's Working Group calculates that if these were cross-subsidized, no budget authority would be required for program expenses for the regular SBIC program, although the cost of administration of the program would still be funded with appropriations.

2. Increase fees charged for SBA examinations.

Immediately seek legislation, as required, to increase examination fees charged to licensees from the current schedule to a new schedule that would cover their cost to SBA. This would increase examination fee income from approximately $700,000 in Fiscal 1995 to approximately $2 million per year thereafter. SBA should also seek legislation to authorize retention of these fees to fund continuing administrative costs (fees are currently paid direct to the Treasury, with no credit to SBA).

3. Change from guaranteed to direct funding.

Under the Federal Credit Reform Act, direct loan and loan guaranty programs are scored the same, since the risk of loss to the Government is the same. Therefore, SBA should seek Congressional authorization to change the funding source for the program to direct funding rather than using SBA's guarantee of securities sold in the public market. This change would allow the Government to acquire, at no cost to the SBIC's, the current 62 basis points of underwriting fees and expenses, and the 65 to 75 basis point spread over Treasury rate which is offered to the purchasers.

Subject to OMB concurrence, the Council's Working Group believes these savings, in addition to the fees set forth above, would reduce the subsidy rates for participating securities and debentures to minus 5.8% and minus 1.9%, respectively, with net income from the program of $27 million. Since this amount exceeds the program's administrative cost, the proposed fees for participating securities could be lowered, while still requiring no appropriation for program cost or administration. This could be facilitated through the establishment of a permanent, indefinite appropriation through a revolving fund financed through negative subsidies.

4. Reduce loss rate assumptions used in computing subsidy rates.

Review loss rate assumptions with OMB to determine realistic levels to be used in computing subsidy rates. Current assumptions are based on historic

experience with much weaker and smaller SBIC's than those licensed under the stringent criteria applied during the past year. A total of 15 major improvements have been made to the program, which should materially reduce future losses.

With a further reduction in subsidy rates justified by evaluation of realistic loss assumptions, SBA should be able to reduce some of the proposed user fees, while continuing to operate with no annual appropriations, at a net income.

5. Improve Administration of the Program.

Secure Congressional approval for more flexible personnel arrangements, including numbers of people and relevant skill sets, in order to manage both risk and public policy purpcses maximally. The specialized financial management skills required in the program may be best secured by contracting out some portion of the program administration under SBA's supervision.

The issue is complex. It involves both appropriate delegations of authority and appropriate alignment of personnel positions and skills. The Council thus recommended that a second and specific Working Group be appointed to review these issues in the detail they deserve.

A sixth recommendation related to Specialized SBIC's (SSBIC's) and was attached to the Council's report in the form of a supplementary comment. It offered for consideration, among other things, a means of reducing the subsidy rate on the SSBIC program by eliminating the current preferred stock and subsidized debentures in exchange for reserving, by statute, some portion of available leverage for SSBIC's and SBIC's to those that concentrate in their investments on the smaller tier of companies.

Inasmuch as the Council did not deliberate these and other SSBIC issues in detail, and since another advisory group is doing so, I mention it here as an important but unresolved issue.

Conclusion

We're here today discussing a unique program, with a 30-year track record of effective financings of and management assistance to, entrepreneurial business across the United States. In the absence of such a vehicle, I ask you where companies go to get the $500,000 required for launch or for growth, coupled with strategic advice.

The Council offers this set of modest proposals in order reasonably to meet very real budget constraints, while keeping a worthwhile program moving ahead at a critical and promising juncture in its history.

We welcome this open forum for questions, for discussion and, hopefully, for early resolution.

Thank you.

Chairman BOND. Thank you very much, Ms. Cloherty. We will make the full statement available in the record for all members of the Committee. Mr. Dunbar.

STATEMENT OF WILLIAM F. DUNBAR, CHAIRMAN, NATIONAL ASSOCIATION OF SMALL BUSINESS INVESTMENT COMPANIES, WASHINGTON, D.C.

Mr. DUNBAR. Thank you, Mr. Chairman. I appreciate the opportunity to testify today. I am testifying in my capacity as chairman of the National Association of Small Business Investment Companies, the professional trade association representing the SBIC industry.

In my professional life, I am president of Allied Capital Corporation II and Allied Investment Corporation II, a wholly owned subsidiary which is an SBIC, with $10 million in funded capital. I also serve as executive vice president of all the other funds managed by Allied Capital Advisers, which includes a second SBIC and an SSBIC. Allied holds the oldest SBIC license in the country, having been founded in 1958.

I would like, at this time, to submit my written testimony for the official record of the Committee and focus my oral comments on the future of the SBIC program and what I believe is a natural progression from the 1992 landmark legislation to privatization of the entire program.

Chairman BOND. We accept your full testimony as presented and we thank you for summarizing.

Mr. DUNBAR. Thank you. Ms. Pulley has alluded to the overhaul of the SBIC program that occurred in 1992 as a result of the work done by the Investment Advisory Council, which Ms. Cloherty chaired. I would just like to reiterate the impact of that program, in terms of reducing the cost and the risk to the Federal Government of the SBIC program.

The creation of the participating securities cured the mismatch of funds between many SBIC's sources and uses of funds. The new minimum capital requirements substantially reduced the risk to the Government. There is now a much larger proportion of private capital which is at risk first. We increased the frequency of examinations, changed the management suitability criteria, changed the valuation guidelines to enhance SBA's ability to monitor SBIC's portfolios. We changed SBA's subordination position, thereby reducing the risk to the Government. We eliminated SBIC's access to bankruptcy protection and made many other changes which dramatically reduced the cost and the risk to the Federal Government of the program.

Since the program became official in April 1994, 50 new SBICs have been licensed and have brought over $740 million in private capital into the program, which is more capital entering the program in the last 14 months than in the last 10 years combined.

I would like also, as Ms. Pulley did, to reiterate the importance of the debenture program. The new program does not apply only to the participating securities program, but debenture users, both new ones and the ones that existed prior to 1992, all operate under the new rules and regulations based on the overhaul. The debenture instrument remains a very vital part of the SBIC program.

When we look to the future of the SBIC program, Mr. Chairman, our industry recognizes and appreciates the environment in which you and your colleagues in the Congress are currently working. The calls to reduce the deficit and decrease the size of Government and balance the budget are loud and persistent. In this environment we believe that it is critical that we continue to explore all possible means of reducing the role of the Federal Government and the budgetary cost to the Federal Government of the SBIC program without undermining the tremendous contribution the program makes to the U.S. economy.

When we look back over the evolution of the funding of the program, we see that until 1986 the program was funded directly by the Department of Treasury's Federal Financing Bank and there was a direct dollar for dollar scoring for the dollars that were funded. Since 1986, the funding has been provided by the public capital markets, generally by institutional investors, with a guarantee by SBA. Under this method of funding, the Government scores on the budget each year a percentage of the guarantee which is called the subsidy rate. The budget impact is then a percentage of that total leverage that is guaranteed.

The program was further privatized under the overhaul in 1992 when Congress significantly increased the percentage of capital that SBICs must raise from private sources. We believe that formation of a Government-sponsored enterprise, a GSE, to fund and manage the program is the logical next step along the privatization continuum. Ultimately we believe the program could be entirely privatized when the GSE drops its GSE status and becomes completely private, just as Sallie Mae is attempting to do at this time.

NASBIC's proposal to privatize the SBIC program presents a framework for creating a private financing structure with continuous oversight by the Government and built-in protections to ensure financial safety and soundness. A copy of our proposal is attached to our written testimony.

Under the proposal, the SBIC program would be lifted out of the SBA and moved into a new private corporation created by an act of Congress. This new corporation would be a Government-sponsored enterprise similar to Fannie Mae or Sallie Mae which will no longer require direct annual Congressional budget appropriations.

The new entity would have a set of characteristics giving the corporation status similar to that provided to Fannie Mae and Sallie Mae, including a charter set forth by Congress, private ownership with SBICs owning the voting common stock, control by a board of directors, Congressional oversight of the corporation's activities, and the authorizations to make loans and investments. We have proposed that the new corporation be named the Venture Capital Marketing Association, or Vickie Mae.

Existing SBICs would provide Vickie Mae's initial capitalization through the purchase of common stock. On a continuing basis, the corporation would build its capital base through capital contributions from newly formed SBICs and charges to SBICs for funds they raise through the corporation. The corporation would earn its capital by profitable operations, by managing the spread on funds paid to the funds, interest rates received on the funds provided to

SBICs, as well as fees charged to SBICs and to the Federal Government for managing the current SBIC portfolio.

Once the corporation has shown positive performance for several years, it may raise additional capital through the sale of stock to private investors. The market ultimately would determine the price of Vickie Mae's securities at a spread to Treasury bonds and based on the characteristics of the GSE.

We believe that under this program we could eliminate the uncertainties that exist in the funding of the program today. The SBIC program could continue to provide investments in small companies. We estimate that over 300,000 jobs would be created over the next 5 years via the SBIC program. We estimate that over $100 million per year in taxes would be generated by the small businesses that receive SBIC financing. And we believe that the budget savings under this new system could be more than $300 million over the next 5 years.

We believe that this form of privatization could serve as the stepping stone to, ultimately, full privatization. Many SBIC professionals believe that this Government-sponsored enterprise could ultimately drop all of its ties to the Federal Government, including budget and oversight responsibilities. Given the opportunity, Vickie Mae would become a stand-alone for-profit corporation serving the financing needs of small growth companies in America.

Designation of GSE status is essential, however, at the outset in order to assure Vickie Mae's ability to issue securities at viable rates.

The SBIC program has served the small business community well over its 36-year history. We ask that you, Mr. Chairman, and members of the Committee, consider all possible alternatives to keep the funding sources for SBIC stable, either by maintaining appropriations levels at or above the president's budget, or by a privatization initiative.

Today's SBICs are better managed and better capitalized. They operate in a more reasonable regulatory environment and are successfully fulfilling the capital needs of small business. Most importantly, today's SBICs are committed to invest in and work with America's small growth companies to help them now and well into the future.

Again, I thank you for this opportunity to share our perspective of the SBIC program. We appreciate your leadership as Chairman of the Senate Committee on Small Business and look forward to working more closely with you and members of the Committee to make the new SBIC program better and American small businesses stronger. Thank you.

[The prepared statement and attachment of Mr. Dunbar follow:]

William F. Dunbar

National Association of Small Business Investment Companies

I appreciate the opportunity to testify today. I am testifying in my capacity as chairman of the National Association of Small Business Investment Companies, the professional trade association representing the SBIC industry.

In my professional life, I am president of Allied Capital Corporation II and of Allied Investment Corporation II, a wholly owned subsidiary which is an SBIC with $10 million in funded capital. I also serve as executive vice president of all the other funds managed by Allied Capital Advisers, which includes a second SBIC, the oldest SBIC in the country, and an SSBIC.

I'd like to address several key issues regarding the SBIC program's historical success, its impact on the capital formation efforts of small business, and what the industry believes is a natural progression from 1992 landmark legislation to the privatization of the entire program.

Historical Success

It is important to understand why Congress created our unique public/private partnership, the Small Business Investment Company program.

The SBIC program found its beginning in a Federal Reserve study conducted in the mid-1950's. The study concluded that sources of long-term loans and equity financing for small businesses were sorely inadequate. The Congress responded to the Federal Reserve Board's observations by passing the Small Business Investment Act of 1958. Provisions of this Act created the Small Business Investment Company program.

Over the 37-year history of the program, SBICs have invested close to $12 billion in 100,000 small businesses around the country. Mr. Chairman, in 1994 alone, 2,348 small businesses across the country received approximately $1 billion in SBIC financing. The stories of SBIC participation in the start-up of Federal Express, Apple, and Intel are familiar to many. The story of the hundreds of thousands of "Main Street, USA" businesses financed by SBICs is not. And it is this story that truly illustrates the impact of SBIC investments.

Many SBIC investments are in unglamorous retailers like the KC-K9 Bakery in Kansas City, Missouri, or Table Toys Inc., in Houston, Texas. The market best served by SBICs includes companies like William Brothers Lumber in Atlanta, Georgia, and Hanger Orthopedic in New Canaan, Connecticut, whose presidents are here today to testify. All of their stories are compelling. And all of their stories illustrate the significant role SBICs play in fulfilling the needs of this underserved market within the small business community.

It is companies like these that would never get the attention of the Wall Street investment banking community because commissions for the firms would be far too small. Borrowings from local banks are either insufficient or impossible to find because small companies often lack hard assets and because their capital needs are relatively small and require a longer term. They need the investments that only an SBIC would be willing to make.

Regional and Industry Diversity

Recent trends in the capital markets have actually decreased small business' ability to raise long-term, patient capital. The funding gap for small growth companies remains acute—particularly for businesses that are not high-technology-based or located in venture capital

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strongholds such as New York, Massachusetts, and California. For thirty-seven years, SBICs have worked to fill that gap. Close to 78% of small businesses funded by SBICs are non-technology-based businesses and well over 50% of SBIC-backed companies were located in areas other than Boston, New York, or the Silicon Valley.

Job Creation

It is recognized that small growth firms are the primary generators of new jobs in America. The job creation and economic development statistics of the SBIC program show this to be among the most efficient programs supporting small business at an astonishing low cost to the American taxpayer.

A study conducted by Deloitte, Haskins and Sells (now Deloitte & Touche) in 1980 concluded that companies financed by SBICs have generated more than ten times the employment growth of all other small businesses. The study found that SBIC-backed companies are extremely efficient at generating substantial job growth. It was determined that one permanent job was created with every $6,463 investment. If we adjust this investment amount to current dollars based on prevailing inflation rates, one permanent job is created for every $17,000 invested by an SBIC.

To add credence to these statistics, I'd like to share the job creation data from one of my industry colleagues in Massachusetts. Pioneer Ventures L.P. invested $18 million in 27 small business concerns from 1984 through 1994. From the time of their original investments to December 31, 1994, those 27 small firms created 6,700 new jobs with only $2,685 invested per job created. More impressively, these firms paid over $38 million in federal, state and payroll taxes in 1994 alone. Mr. Chairman and Members of the Committee, these are just 27 of the 100,000 small businesses across the country that have received SBIC backing.

Cost to the Government

The cost of the SBIC program to the government, or perhaps more accurately the American taxpayer, is more than reasonable over the program's history. Through September 30, 1994, $2.6 billion has been disbursed to regular SBICs by SBA. As of that date, SBA had charged off only $197 million. In addition, SBA projected that an additional $170 million would eventually be charged off against assets currently in the liquidation portfolio, and $57 million against assets currently in the active portfolio. The total cumulative cost at fiscal year end 1994 on a "credit-loss" basis of the regular SBIC program would be $424 million, or approximately 16% of total historical disbursements. This of course does not take into account the operating expenses for the Investment Division of SBA, but neither does it factor in tax revenues produced by the small business concerns, tax revenues produced by the SBICs, or personal income taxes paid by the employees of the small concerns.

The 1992 Investment Advisory Council report, *Financing Entrepreneurial Business: An Agenda for Action* stated simply, "More than one-half billion dollars of direct taxes have been paid by corporate-form SBICs to the federal government. Additionally, partnership and corporate SBICs have paid in excess of $800 million of dividends to their owners, much of which is taxable income." The report concluded this discussion by observing, "The Subcommittee could not estimate the level of taxes generated by small businesses financed by SBICs, nor the personal income taxes of individuals whose jobs were created by SBIC-financed companies. The statistics would be impressive. As an example, $787.3 million of taxes have been paid by Intel Corporation alone during its history." As I mentioned earlier, the 27 companies that received backing from Pioneer Ventures paid over $38 million in federal, state and payroll taxes in 1994 alone. Mr. Chairman, we believe that the SBIC program is a unique public/private partnership that works. It works to create

jobs and it works to create wealth, prosperity, and opportunity for America's aspiring entrepreneurs.

Legislative Overhaul

In 1989, the SBIC industry recognized the fact that in spite of the tremendous benefits the program had already generated for the U.S. economy, there were shortcomings in the operations of the program. Working closely with the leadership of both small business committees in Congress, along with the U.S. Small Business Administration, and the Investment Advisory Council, we helped overhaul the SBIC program.

The new, revamped SBIC program was signed into law in September of 1992 and the regulations implementing the law became effective in April of 1994. The fundamental problems of the program were addressed and corrected. Included in the overhaul were many changes made to both the cost and the risk of the program to the federal government. The changes in the SBIC program include corrections to major defects that will considerably reduce program losses in the future. Some of the key revisions include:

1. The creation of a new equity funding mechanism called the Participating Security. The new participating security cures the mis-match between the SBIC's sources and uses of funds.

2. New minimum capital requirements that will make SBICs economically viable while their investments are growing.

3. More frequent examinations of SBICs to protect both the government's interests and the SBIC's.

4. New management suitability criteria in an effort bring only experienced venture professionals into the program.

5. New valuation guidelines that will provide a consistent standard in which to monitor an SBIC's portfolio company valuations.

6. New cost of money calculations that allow an SBIC to apply its own average cost of capital calculations to set a base for their interest rate ceiling. This feature allows an SBIC to structure its investments based on its actual cost of funds.

7. Changing SBA's subordination position. SBA is no longer subordinated to third party lenders.

8. New credit-worthiness evaluations that are performed at the time of licensing and before each SBIC draws down leverage.

9. Preclusion of an SBIC's access to bankruptcy protection.

10. New criteria for ownership and management diversity.

Since the new program officially began in April 1994, 50 new SBICs have been licensed. These 50 SBICs have raised $741 million in private capital, representing more private capital entering the SBIC program in 14 months than in the last ten years combined. On February 22, 1995, the first funding using the new Participating Securities allowed nine SBICs to obtain $73 million from the capital markets for investment in small businesses. This funding, coupled with private capital from the participating SBICs made available over $100 million for investing into small businesses immediately.

A colleague of mine in a Kansas-based SBIC has already invested part of the proceeds from this landmark funding in seven early-stage companies in the midwest. I stress early-stage because it is the Participating Security that permits him to provide the long-term patient capital those seven companies will need to grow strong, create jobs, create wealth within their communities, and generate tax revenues.

The Participating Security enables SBICs to invest in riskier, smaller businesses by deferring a portion of the interest which SBICs pay to the federal government in the earlier years of the SBIC's life. In exchange for the deferral, the government receives a participation in the profits of the SBIC, thus creating the strong possibility that the SBIC program may cost much less in the near future and may actually generate a profit for the government.

Importance of the Debenture Program

It is important to clarify that the "new" SBIC program does not apply only to SBICs using the new Participating Security. The "new" SBIC program includes SBICs using the Debenture instrument as well. The industry views the "new" SBIC program as the new environment in which all SBICs operate since the 1992 legislation and 1994 regulatory implementation of the legislation.

As outlined in the ten key revisions earlier, the regulatory changes mutually improve the operating environment for both SBICs and the federal government. While the new Participating Security clearly addresses one of the basic flaws of the program, the Debenture instrument remains a vital part of the SBIC program. For SBICs that make loans, the Debenture is still an ideal form of leverage. SBICs continue to use the debenture form of financing to make loans to healthy businesses that don't have the same "home run" return potential that is characteristic of companies receiving equity investments. These lender SBICs also fill a niche in the small business community that is desperately under-served, providing long-term capital to entrepreneurs who prefer to maintain 100% ownership in their companies.

As of July 7th, 17 SBICs using the Debenture instrument have been licensed within the "new" program. These 17 new SBICs alone brought $188 million in private capital into the program. Combining this fresh capital with the nearly $2 billion in private capital raised by Debenture-using SBICs licensed prior to the new regulations and the $564 million in leverage already drawn down, the small business community has access to a considerable pool of long-term, patient capital.

The Future of the SBIC Program

Mr. Chairman, our industry recognizes and appreciates the environment in which you and your colleagues in the Congress are working. The calls to reduce the deficit, decrease the size of government, and balance the budget are loud.

In this environment of fiscal restraint, we believe it is critical that we continue to explore all possible means of reducing the role of the federal government and the budgetary cost to the federal government of the SBIC program—without undermining the tremendous contribution the program makes to the U.S. economy. Our industry is committed to studying every possible means of reducing the cost of the SBIC program to the American taxpayer.

The Privatization Continuum

Prior to 1972, the SBIC program was entirely underwritten by the SBA directly purchasing SBIC debentures. This system of funding was dollar-for-dollar and reflected the full cost of the program on the budget. From 1972 through 1986, funding for the program came from the Department of the Treasury Federal Financing Bank (FFB). This funding mechanism also produced dollar-for-dollar budgeting. Since 1986, funding for the program has been provided by the public capital markets, primarily institutional investors. The SBA guarantees payments of principal and interest to the investors. Under this method of funding, the government scores on the budget each year the present value of the expected losses over the life of the debentures, which is called the subsidy rate. The budget impact under this funding system is only a percentage of the total leverage guaranteed.

We believe formation of a government-sponsored enterprise (GSE) to fund and manage the program is the logical next step along the privatization continuum. Ultimately, the SBIC

program would be entirely privatized when the GSE drops its access to the Treasury backstop and becomes completely private just as Sallie Mae is seeking to do now.

The Venture Capital Marketing Association

NASBIC's proposal to privatize the SBIC program provides a means to address the critical public purpose for which the program was designed—to provide for the "growth, modernization and expansion of small business." Our proposal presents the framework of creating a private financing structure with continuous oversight by the government and built-in protections to ensure safety and soundness. (A copy of NASBIC's proposal, including financial models, is attached to this testimony for your review.) Under the privatization proposal, the SBIC program will be lifted out of the SBA and moved into a new private corporation created by an Act of Congress. This new corporation will be a government-sponsored enterprise (similar to Fannie Mae) which will no longer need Congressional budget authority or appropriations. The new entity will have a set of characteristics giving the corporation status similar to those provided to Fannie Mae and Sallie Mae which include a charter set forth by an Act of Congress, private ownership with SBICs owning the voting common stock, control by a Board of Directors, Congressional oversight of the corporation's activities, and the authorization to make loans and investments. We propose that the new corporation be named the Venture Capital Marketing Association, or Vickie Mae.

The new corporation will be a privately owned and privately managed for-profit corporation. Existing and newly formed SBICs will be stakeholders in the corporation through the purchase of voting common stock. Policy direction for the corporation, within specific statutory parameters set by Congress, will be provided by a Board of Directors. The majority of the Board will be elected by the voting common stockholders, with the

balance appointed by the President. The day-to-day operations will be carried out by a highly qualified professional management team.

Existing SBICs will provide Vickie Mae's initial capitalization through the purchase of common stock. On a continuing basis, the corporation will build its capital base through capital contributions from newly formed SBICs, charges to SBICs for funds they raise through the corporation, capital contributions for increases in the capital of operating SBICs, and internally generated retained earnings. The corporation will also earn its capital base by profitable operations from the spread on funds in managing the current portfolio at SBA and from fees charged to SBICs. Once the corporation has shown positive performance for several years it may raise additional capital through the sale of stock to private investors, such as pension funds, banks or other institutional investors. Under privatization, the guarantee is implicit. The market will determine the price of Vickie Mae securities at a small spread to Treasury bonds and based on the characteristics of the government sponsored enterprise.

The enclosed NASBIC proposal provides detailed information on exactly how the new government-sponsored enterprise (GSE), or "Vickie Mae" would work. The proposal also explains how Vickie Mae would regulate SBIC business practices, how the government would oversee the operations of the corporation, and the actual budget treatment of this potential GSE. We have brought together industry professionals, investment bankers, legal counsel, consultants and accountants to develop the financial models for Vickie Mae. Those models are also included for your review.

We are confident that the benefits of privatizing the SBIC program will be substantial. Here's why.

The public policy goals will continue to be met.

- Over the next five years, the small growth companies in which SBICs invest will create over 300,000 permanent new jobs.
- New tax revenues will be produced from taxes paid by the expanded SBIC industry. On a combined basis with taxes from the companies in which SBICs invest, new tax revenues should exceed $100 million per year, further supporting the deficit reduction goals of Congress.
- SBA's regulatory and support offices for the SBIC program will not be needed—creating additional savings realized from reductions in staff and related overhead expenses.
- The budget savings from the new system will be more than $300 million over the next five years.

Small business will benefit.

- The new system will produce a material increase in the flow of investments into small growth firms. We estimate that $5 billion over the next five years will be invested in American small growth firms.
- There will be an expanded and stable source of early-stage venture financing for new entrepreneurial start-up companies.
- The new system will provide significant amounts of expansion capital for small firms that have been shut out of the market for commercial bank financing.

This privatization initiative serves as the stepping stone to full privatization. SBIC industry professionals, myself included, foresee this government sponsored enterprise as a vehicle to full privatization where all ties, both budget and oversight responsibilities, are severed. Vickie Mae, given the opportunity, would become a stand-alone, for-profit corporation serving the financing needs of small growth companies in America.

The overwhelming expansion of the SBIC program and of the demand for leverage by SBICs from the federal government has placed enormous pressure on current appropriation levels. The funding levels required to meet the demand by licensees, and the needs of small businesses themselves, dramatically exceeds the current appropriations. <u>There is a tremendous sense of urgency to begin working towards full privatization.</u> We believe that

it is truly possible to design a program that would reduce or eliminate the need for direct, annual appropriations while providing a consistent source of funding from the capital markets to enable SBICs to continue providing long-term patient capital to small growth companies.

We understand that a full shift to privatizing the SBIC program could be a lengthy and arduous one, but we are willing to work with the Congress. In the meantime, we urge your support of current and future funding levels for the SBIC program.

Today's SBIC: New Design, Renewed Commitment

In a study conducted by Arthur Andersen's Enterprise Group and National Small Business United in 1993, thirty percent of the survey's respondents claimed that access to capital is a significant challenge to the growth and survival of their small and mid-sized companies. In preparation for the White House Conference on Small Business, SBA's Office of Advocacy conducted a study called, "Small Business and Entrepreneurship in the Twenty-First Century." Various focus groups were called together to discuss the obstacles-and opportunities that small businesses will face in the year 2005. The discussions were provocative. Repeatedly, the focus groups determined that gaining access to capital will be a linchpin to small business and entrepreneurial growth.

The SBIC program has served the small business community well over its 37-year history. We ask that you Mr. Chairman and Members of the Committee consider all possible alternatives to keep the funding sources for SBICs stable, either by maintaining appropriations levels at or above the President's budget, or a by privatization initiative. Today's SBICs are better managed and better capitalized. They operate in a more reasonable regulatory environment and are successfully filling the capital needs of small

business. Most importantly, today's SBICs are committed to invest in and work with America's small growth companies to help them now and well into the future.

Again, thank you for this opportunity to share our perspective of the SBIC program. We have appreciated your leadership as Chairman of the Senate Committee on Small Business and look forward to working more closely with you and Members of the Committee to make the new SBIC program better and American small businesses stronger. Thank you and I submit this testimony for the official record of the committee.

A PROPOSAL

TO

<u>PRIVATIZE THE SBIC PROGRAM</u>

THE NATIONAL ASSOCIATION
of
SMALL BUSINESS INVESTMENT COMPANIES
(NASBIC)

June, 1995

PRIVATIZING THE SBIC PROGRAM

Contents

INTRODUCTION

This proposal sets forth a viable plan to "privatize" the Small Business Investment Company (SBIC) program - a program that is now managed by the Small Business Administration (SBA).

Small business concerns are continually faced with serious difficulty in obtaining long-term patient capital required for growth and development. Commercial banks do not furnish such financing. Private venture capital funds selectively invest large amounts in a narrow range of companies with exceptional prospects for growth. As a result, there is a huge gap between the small business sector's critical need for long-term growth capital and the availability of this type of financing. The SBIC industry was designed to fill this gap and provide capital to this most important segment of the U.S. economy. This proposal provides a means to address this critical public purpose through a private financing structure, with continuous oversight by the government and built-in protections to assure safety and soundness.

The current SBIC program operates as a partnership between the private sector and the Federal government. SBICs are private investment companies that provide long-term patient capital to small businesses. SBICs are capitalized with private funds and managed by skilled venture professionals who make their investment decisions without interference from the government. SBICs have invested in excess of $11 billion in more than 100,000 small growth companies in the past 35 years, and have produced a net positive return to the government.

The program is currently housed in the Small Business Administration (SBA), and SBICs are subject to licensing and regulation by the SBA. As licensed and regulated companies, SBICs can raise additional capital by selling SBA-guaranteed securities in the capital markets. While this system provides an increased pool of funds for SBIC investments in small business, it also requires budget authorization and annual appropriations by Congress.

Under the privatization proposal the SBIC program will be lifted out of the SBA and moved into a new private corporation created by an Act of Congress. This new corporation will be a "government-sponsored enterprise" (similar to Fannie Mae) which will no longer need Congressional budget authority or appropriations. It would be named the Venture Capital Marketing Association, or Vickie Mae.

The benefits of privatizing the SBIC program will be substantial. The Federal government will realize significant budget savings while reducing the size of a government agency - SBA. The small growth firms in which SBIC's invest will create new permanent jobs and generate new tax revenues. Small businesses will gain access to capital markets now closed to them, and there will be expanded opportunities for new start-up companies. Finally, the system of financing small business will be materially improved by providing SBICs a dependable flow of funds for investment.

WHY IT MAKES SENSE TO PRIVATIZE THE SBIC PROGRAM

Public Policy Benefits

- Budget Savings - The new system will reduce budget outlays by approximately $250 million over the next five years.

- Downsizing SBA - SBA's complex regulatory and support apparatus for the SBIC program will not be needed. A full SBA division of over 90 staff positions can be cut, and additional savings realized from reductions in support personnel and related overhead costs.

- Increased Tax Revenues - New tax revenues will be realized from corporate taxes of the growth companies in which SBICs invest and income taxes of their employees. New tax revenues also will be produced from taxes paid by the expanded SBIC industry. On a combined basis, new tax revenues from these sources should exceed $100 million per year, further supporting the deficit reduction goals of Congress.

- Job Creation - Over the next five years, the small growth companies in which SBICs invest will create over 300,000 permanent new jobs.

- New Technologies - The increased number of SBICs investing in new and expanding high-tech companies will bolster the development of new technologies.

- Reduced Regulations - A large block of highly complex SBA regulations, which federal regulators now use to micro-manage the SBIC program, will be wiped off the books.

Small Business Benefits

- Increased Access to Growth Capital - The new system will produce a material increase in the flow of investments into small growth firms, estimated in the range of $5.0 billion over the next five years.

- New Opportunities for Start-Ups - New entrepreneurial start-up companies, which have very limited access to capital, will have an expanded and stable source of early-stage venture financing.

- Enhanced Capacity for Expansion - The new system will provide significant amounts of expansion capital for small firms that have been shut out of the market for commercial bank financing.

WHAT IS VICKIE MAE

A new off-budget, government-sponsored enterprise (GSE), named the Venture Capital Marketing Association, or "Vickie Mae" would be chartered by Congress to act as a capital bank for the SBIC industry. This new corporation will be similar to the Federal National Mortgage Association (Fannie Mae) and the Student Loan Marketing Association (Sallie Mae). It will replace all of the SBIC program functions now performed by SBA.

Ownership - The new corporation will be a privately owned and privately managed, for-profit corporation. Existing and newly formed SBICs will be stakeholders in the corporation through the purchase of voting common stock.

Management - Policy direction for the corporation, within specific statutory parameters set by Congress, will be provided by a Board of Directors. The majority of the Board will be elected by the voting common stockholders, with the balance appointed by the President. Day-to-day operations will be carried out by a highly-qualified professional management team.

Status as a "Government-Sponsored Enterprise" (GSE)
The new entity will have a set of characteristics giving the corporation status as a "government-sponsored enterprise." These features, which are the same as those provided to Fannie Mae and Sallie Mae, include:

- Chartered by an Act of Congress.
- Private ownership with SBICs owning the voting common stock.
- Control by a board of directors, the majority of whom (10) are elected by the stockholders (the SBICs). Five public directors are appointed by the President.
- Congressional oversight of the corporation's activities.
- The corporation is a financial institution authorized to make loans and investments, and its securities are legal investments for federally-supervised financial institutions.

Capitalization - Existing SBICs will provide the corporation's initial capitalization through the purchase of common stock. On a continuing basis, the corporation will build its capital base through:

- Capital contributions from newly-formed SBICs,
- Charges to SBICs for funds they raise through the corporation,
- Capital contributions for increases in the capital of operating SBICs.
- Internally generated retained earnings.

In addition, after the Corporation has shown positive performance for several years it may be able to raise additional capital through the sale of stock to private investors, such as pension funds, banks or other institutional investors.

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HOW VICKIE MAE WILL WORK

Funding Mechanism

Funds From the Capital Market - The corporation will serve as capital bank for SBICs. It will raise funds by selling its own securities in the capital markets securitized by packages of SBIC securities. The corporation's "government-sponsored enterprise" status will enable it to raise funds at a rate spread slightly above comparable U.S. Treasury securities, making the effective cost of funds to SBICs reasonable.

Funding for SBICs - The corporation's principal activity will be to provide funding for SBICs through the purchase of their securities. The Board will establish eligibility standards for SBIC funding. The corporation will be authorized to provide financing through a variety of debt and equity securities which match the capital needs of SBICs.

Management of the Outstanding SBIC Portfolio

Debentures of Operating SBICs - All currently outstanding SBIC Debentures and Preferred Stock in SBA's portfolio would be transferred to the corporation under a service contract. The corporation would manage and service those securities for the government for a fee.

Participating Securities of Operating SBICs - All Participating Securities in SBA's portfolio would be acquired by the corporation and managed by the Corporation for its own account.

The SBIC Liquidation Portfolio at SBA
All SBIC securities and assets in liquidation status at SBA would also be transferred to the corporation under a service contract. The corporation would manage and service the liquidation of those assets for a fixed fee, plus an incentive fee for achieving outstanding recoveries.

VICKIE MAE REGULATION OF SBIC BUSINESS PRACTICES

Entry Into The Program and Qualifications To Do Business - Existing SBICs in good standing will automatically qualify to do business with the corporation. The Board will establish standards of entry for new SBICs, including standards for minimum capitalization, quality and experience of management, probability of adequate profitability and financial soundness.

Regulation of SBICs - SBICs will enter into a contract with the corporation, under which they will be contractually bound to abide by the corporation's operating rules and standards.

Within guidelines spelled out by Congress in the enabling legislation, the Board will establish rules governing all appropriate aspects of an SBIC's business operations. These will include definitive rules in the major regulatory areas covered by the current program, which are:

- Conflict of interest transactions are prohibited.
- Investments can only be made in the qualified small businesses.
- Control of small firms is restricted.
- Diversification of investment risk is required.
- Investments in certain highly speculative or unlawful activities are prohibited.

Each SBIC will be subject to examination by the corporation to assure the SBIC is in compliance with the corporation's rules.

Enforcement of the Rules - The enabling legislation will require the corporation to adopt measures to assure compliance with its rules, and will give the corporation several specific enforcement powers, including:

- Termination or suspension of agreements between the corporation and an SBIC,
- Termination of an SBIC's qualification to do business with the corporation,
- Assessment of penalties against an SBIC or its officers, directors or general partners,
- In appropriate cases, the authority to remove officers, or directors or general partners of the SBIC,
- In appropriate cases, the authority to take over control and operation of the SBIC, and
- In cases involving potential criminal activity, referral of violations to the U. S. Attorney.

The corporation will also have access to all appropriate civil remedies where an SBIC has breached its contractual agreement, including, acceleration of debt in cases of default, actions to enforce contractual covenants, and initiation of litigation against the SBIC.

GOVERNMENT OVERSIGHT OF VICKIE MAE

Oversight of the Corporation's Financial Performance

Standards For Financial Safety and Soundness - The enabling legislation will establish standards and tests of financial safety and soundness for the corporation. These standards will be similar to those required for other government-sponsored enterprises. Compliance with these standards will be monitored by a designated government official.

Independent Audits - The corporation will be audited annually by an independent CPA.

Government Oversight - The corporation will make an annual report to Congress and the President on the corporation's operations, including an assessment of the corporation's financial safety and soundness.

The Small Business Committees of Congress and SBA will have authority to review the corporation's compliance with the Congressionally established financial standards. The corporation will be subject to a financial audit at any time by SBA, or by GAO at the request of either Small Business Committee of Congress.

The Small Business Committees of Congress, GAO and SBA will have access to the corporation's financial books and records at any time.

Treasury Approval of Securities Issued by the Corporation - All obligations issued by the corporation will require approval by the Treasury Department. Similar Treasury approval is required for securities issued by all other government-sponsored enterprises, such as Fannie Mae and Sallie Mae.

Oversight of the Corporation's Regulatory Performance

Regulatory Standards - The enabling legislation will establish basic standards for the corporation's regulatory activities.

Government Oversight - The corporation will make an annual report to Congress and the President on the corporation's operations, including an assessment of the corporation's regulatory activities.

The Small Business Committees of Congress and SBA will have full authority to review the rules established by the corporation for SBIC business practices, and the corporation's regulatory operations, at any time.

The Small Business Committees of Congress, GAO and SBA will have access to the corporation's regulatory books and records at any time.

FACTORS WHICH MITIGATE THE GOVERNMENT'S RISK

A series of factors inherent in the Vickie Mae proposal strongly mitigate the government's risk of loss or the Treasury backstop authority ever being used These include:

Motivation to Make Vickie Mae work - The success of Vickie Mae is quite important to every SBIC because they are investors in the corporation. But, of far greater importance is the SBIC industry's motivation to assure that Vickie Mae succeeds because of the consequences of failure. The SBICs clearly realize that if the Congress and the Treasury are ever required to "bail out" the enterprise, it would literally mean the end of the industry.

Fundamental Risk Reduction Changes in the Program - The reform legislation of 1992, and the new regulations adopted to implement that law, eliminated prior practices which had led to losses in the SBIC debenture program. These changes include new requirements for: substantially increased private capital for each SBIC; correction of the high-risk mismatch between an SBIC's borrowing and its investments; lower leverage ratios; consistent valuation standards where none existed before; diversity between management and ownership, the lack of which was previously abused; elimination of high-risk real estate plays; limitations on SBA's subordination as a creditor; and a series of regulatory changes that now give SBICs the means to generate additional income. While difficult to quantify, it is reasonable to posit that administration of the program under these new regulations will materially reduce the rate of loss which has been associated with the conduct of the program over the past thirty-five years.

Financial Performance Standards - The enabling legislation sets forth a series of financial standards which must be continually met by Vickie Mae. They involve such matters as requirements for minimum capital, tests of credit risk and interest rate risk, valuation of linked portfolio assets, and standards for dividend distributions. These provisions will help to assure the financial safety and soundness of the corporation's operations.

Improved Quality and Experience of SBIC Managers - Qualification requirements for SBIC managers were substantially increased when the program was revised in 1992. Applicants for an SBIC license must now have extensive experience in venture investments and a proven, successful track record. This requirement for management to have a high level of proven ability and experience will be continued under Vickie Mae, giving greater assurance that SBIC portfolio investments will be of the best quality.

Industry's Private Capital at Risk Before the Government - As the projections indicate, once the corporation goes through an initial growth period, its retained earnings increase dramatically (to approximately $500 million) and capital contributed by the SBICs continues to grow. This equity base provides a substantial cushion to shield the government's exposure to risk. In addition, the aggregate capital of the industry grows rapidly to $3.0 billion, further insulating the government from loss.

Corporate Leadership From Industry Professionals - The majority of Vickie Mae's Board of Directors will be drawn for the leadership of the SBIC industry. Their direction will insure that policies of the corporation are guided by a group of professionals who understand the venture business in detail and have a vested interest in the corporation's success.

Professional Management of the Corporation - The company's day-to-day operations will be managed by a highly-qualified team of private-sector professionals. Vickie Mae will be able to attract a caliber of staff similar to Fannie Mae and Sallie Mae. With all due respect, this will be a marked improvement over the management of the program by the government employees in SBA's Investment Division.

BUDGET TREATMENT OF GOVERNMENT-SPONSORED ENTERPRISES

The History of GSEs

Since the 1930s, Congress has created a number of government-sponsored enterprises ("GSEs") to provide capital to various sectors of the economy, including homeowners, farmers, colleges and students. While the GSEs received Federal charters provided in Federal statutes, GSEs are privately owned and operated. They are limited in their activities to specific economic sectors and given certain benefits that help them accomplish their goals.

GSEs include the following entities: the Federal Home Loan Mortgage Corporation ("Freddie Mac"), the Federal National Mortgage Association ("Fannie Mae"), and the Student Loan Marketing Association ("Sallie Mae").

None of the GSEs are subject to the Congressional budgetary process because the GSEs are not under the control of the U. S. Government. In light of the public purposes described in the charters of these entities, the Government has an interest in the activities of the GSEs. The President of the United States appoints one-third of the directors of Fannie Mae and Sallie Mae. And, there is explicit regulation of the safety and soundness of each GSE by a Federal regulator.

Because of the Federal charter, the public purposes and the Federal regulation of GSEs, the capital markets view the GSEs as excellent credit risks. Accordingly, debt obligations of the GSEs are issued at yields with relatively narrow spreads over comparable maturities of debt obligations of the U. S. Treasury.

The Omnibus Budget Reconciliation Act of 1990 (the "Act")

In 1990, a number of proposals were made to the Congress to significantly alter the exclusion of GSEs from the budgetary process. The so-called summit agreement on the budget, reached by the Administration and the 101st Congress and memorialized in the Omnibus Budget Reconciliation Act of 1990 (the "Act") rejected these proposals. In lieu thereof, a study was mandated from the Treasury Department on the financial safety and soundness of the GSEs, the adequacy of the existing regulatory structure for GSEs and the financial exposure of the Federal Government posed by GSEs.

The Act did contain the Credit Reform Act of 1990 as one of its titles (the "Credit Act"), which dealt principally with the budgetary treatment of direct loans and loan guarantee programs. The Congress concluded that the cash accounting basis of the Federal budget overstated the real economic costs of direct loan programs and understated the real economic costs of loan guarantee programs in the year the loans were made. The Act provided for a revised system of accounting for Federal credit programs that required the appropriation of budget authority equal to the estimated net present value of the cash flows associated with Federal direct loan and loan guarantee programs.

But, the Conference Report on the Act made a clear distinction between the budgetary treatment of GSEs and direct or guaranteed loans. It stated:

> "The Senate amendment defines a Government-sponsored enterprise (GSE) to emphasize that to qualify as a GSE and thereby escape Budget Act treatment, a GSE

must: have a Federal charter; be privately owned; be controlled by a board of directors elected by the owners; and be a financial institution with powers to make loans, guarantee loans, issue debt or guarantee the debt of others. Further, a GSE could not exercise powers that are reserved to the Government (e.g. taxing powers or regulating interstate commerce), commit the Government financially, or employ Federal civil servants." (Omnibus Budget Reconciliation Act of 1990, Conference Report, p. 1164)

Vickie Mae Qualifies as a GSE

The legislation proposing the creation of Vickie Mae contains all of the provisions cited in the conference report. Vickie Mae would have the following characteristics to qualify it as a GSE:

- A Federal charter - it is chartered by an Act of Congress;
- Private ownership - ownership by SBICs who are the stockholders;
- Controlled by a board of directors elected by the owners - the owners elect ten of the fifteen members of the board of directors;
- A financial institution with powers to make loans, guarantee loans, issue debt or guarantee the debt of others - Vickie Mae is empowered to carry out these functions.
- Vickie Mae would not exercise powers reserved to the Government.
- Vickie Mae would not commit the Government financially (the Treasury backstop is contingent. It requires an appropriation of funds by Congress, and the Treasury's determination to use those funds is discretionary).
- Vickie Mae would not employ Federal civil servants.

If Congress were to enact the Vickie Mae legislation in its proposed form, there is no doubt that Vickie Mae will qualify as a GSE and the activities and operations of Vickie Mae will not be subject to the limitations and restrictions of the Federal budgetary process.

The Potential Success of Vickie Mae Compared to Other GSEs

Vickie Mae has the potential to be as successful as such other GSEs as Fannie Mae, Freddie Mac and Sallie Mae. Those GSEs have had remarkable success because they have been able to achieve high profit levels by maximizing their GSE benefits and minimizing interest rate (borrowing) and credit risks.

Vickie Mae will be investing in venture capital enterprises which will have greater potential for profit than investments by the other GSEs, but also greater investment risks. However, SBICs have proven that the venture capital industry can be profitable while producing enormous benefits for the American economy. Additionally, the recent legislation and regulatory changes to the SBIC program have materially reduced the risks historically associated with this investment program. Creating Vickie Mae will move the program from control of the SBA into the private sector, providing Vickie Mae the opportunity to devote skilled professionals to the direction and management of the corporation's affairs.

Continued access to a flow of capital provides the motivation to make Vickie Mae a successful operation. Vickie Mae will give the SBIC industry an opportunity to grow and prosper, and the chance to attract an amount of private capital which will further enhance Vickie Mae's ability to achieve success.

Highlights of SBIC Operational Data

	1998	2001	2004	2007	2010
Number and Composition of New SBICs					
Participating Securities SBICs	76	110	140	161	176
Debenture SBICs	57	91	121	149	178
Total	133	201	261	310	354
Private Capital of New SBICs ($ in millions)					
Participating Securities SBICs	$1,520	$2,200	$2,800	$3,220	$3,520
Debenture SBICs	570	910	1,210	1,490	1,780
Total	$2,090	$3,110	$4,010	$4,710	$5,300
Leverage Taken Down ($ in millions)					
Participating Securities SBICs	$490	$445	$371	$385	$595
Debenture SBICs	$261	$294	$283	$362	$473
Investment Dollars Disbursed ($ in millions)					
Participating Securities SBICs	$694	$627	$523	$538	$840
Debenture SBICs	$352	$397	$382	$489	$630
Number of Investments					
All SBICs	1,897	1,605	1,225	1,201	1,485

Highlights of the Vickie Mae Financial Projections

	1998	2001	2004	2007	2010
		($ in millions)			
Income Information					
Net Investment Income	($74.1)	$ 7.1	$126.2	$161.1	$114.7
Other Income	18.0	1.1	(4.7)	(9.9)	(11.5)
Income before taxes	(56.1)	8.2	121.5	151.2	103.2
Income taxes	0	0	(42.5)	(52.9)	(36.1)
Net Income	($56.1)	$8.2	$79.0	$98.3	$67.1
Balance Sheet Information					
Assets	$2,126	$3,760	$4,238	$4,363	$5,176
Liabilities	2,156	3,787	4,054	3,916	4,494
Equity					
Invested Capital	45.1	80.2	108.5	135.3	172.2
Retained Earnings	(75.1)	(107.6)	75.9	312.0	510.3

THE MODEL

Persons Who Developed the Model

SBIC Industry:

William F. Dunbar	Executive Vice President, Allied Capital Advisers, Inc.
Edward C. Brown	Managing Partner, Hanifen Imhoff Capital Partners
Walter Cunningham	General Partner, Unco Ventures, Ltd.
Christopher W. Dick	Partner, Pioneer Ventures, L.P.
Michael F. Elliot	Director, NationsBank Leveraged Capital Group
Keith R. Fox	President, Exeter Venture Lenders, L.P.
David McL. Hillman	Executive Vice President, PNC Equity Management Corp.
Suzanne Kriscunas	Director, Banc One Capital Partners Corp.
Warren L. Miller	President, Florida Capital Ventures, Ltd.
James F. O'Donnell	Chairman, Capital for Business, Inc.
James A. Parsons	General Partner, RFE Investment Partners
Raymond R. Rafferty, Jr.	General Partner, Meridian Venture Partners
William Reisler	Vice President, Kansas Equity Partners
Peter F. McNeish	President, NASBIC
James M. Trainor	Vice President, NASBIC

Certified Public Accountants:

F.H. Heerde, Partner	Partner, Financial Advisory Services, Coopers & Lybrand
Michael E. Imber	Coopers & Lybrand

Investment Bankers:

Michael K. Clare	Vice President, Chemical Securities, Inc.
Frederick O. Terrell	Managing Director, CS First Boston

Legal Counsel:

James E. Murray	Partner, Brown & Wood
Michael B. Staebler	Partner, Pepper, Hamilton & Sheetz

Consultants:

Robert J. Dotchin	Partner, The Advocacy Group
Frank H. Hill	Partner, The McMillan Group
Kenneth S. Levine	Partner, Wunder, Diefenderfer, Cannon & Thelen

Variables in Building the Vickie Mae Model

Number of New SBICs Licensed - While we have attempted to show a pattern of new licensees that is consistent with current interest in the program, it is inherently difficult to predict what will happen when the program is privatized. Based on the number of new SBICs licensed in fiscal year 1994 (35) and the number of pending licenses (60), we determined that the projected schedule of new licenses (for both participating securities and debentures, net of withdrawals or liquidations) was conservative and reasonable.

Default Rate of SBICs Using Debenture Leverage - While the debenture form of leverage is not a new program, there are many things about the program today and in the future that are different from the history of the past 35 years. First, most of the capital in the program during the period covered by the model will be coming from new SBICs with new managers. Second, these new SBICs will be far better capitalized than in the past ($10 million average private capital versus $3 million in the past). Third, the new regulations adopted pursuant to the 1992 reform legislation will curtail many of the practices that led to the high default rates of the past. Nonetheless, despite the fact that the model is very conservative in using a default rate as high as the historical average, projecting performance of a new crop of SBICs is inherently risky and has a significant impact on the results of Vickie Mae.

Investment Performance of SBICs using Participating Securities - Since the Participating Securities form of leverage is a new program, we have no historical information to use in the Vickie Mae model. We have used the best industry information available in constructing the model for these new SBICs. Venture Economics, publisher of the Venture Capital Journal, has done comprehensive studies of investment performance by non-SBIC venture funds over the past 20 years. The Vickie Mae model has used a more conservative version of the venture industry averages. Even though we have assumed investment returns that are well below the industry averages over a long period of time, it is inherently difficult to project performance of new venture capital funds.

Timing of Returns From Participating Securities - An issue closely related to investment performance is the timing of the cash received from the SBICs using Participating Securities. Since payments are not made according to a fixed schedule, it is more difficult to project exactly when an SBIC will distribute cash to Vickie Mae. We again have used data from the Venture Economics performance surveys as the basis for the timing of returns, and again we have used assumptions that are more conservative than the industry data. This set of assumptions has the greatest impact on Vicki Mae's cash balance in the early years of the model, and the actual results could vary widely from the projection.

Vickie Mae Overhead and Staff Expenses - The Vickie Mae model assumes an initial level of General and Administrative expenses of $5.75 million, increasing by 5% each year thereafter. This assumption is consistent with $6.0 million for administrative expenses which SBA has used in its modeling.

Probability of Various Outcomes

NASBIC is in the process of developing different scenarios, which Coopers & Lybrand will compile, that would show the financial impact of outcomes that are less optimistic than our "base case" set forth in the model, and also outcomes that are more optimistic. The base case represents the industry's best estimate of expected results while using very conservative assumptions. For example, the investment returns and default rates are worse in the base case than what the industry has experienced over time. While it is difficult to assign probabilities to these various outcomes, we believe that the likelihood of the actual results being worse than the base case is less than 20%, while the probability of the actual outcome being better than or equal to the base case is 80%.

VENTURE CAPITAL MARKETING ASSOCIATION
(A Proposed Government Sponsored Enterprise)

PROJECTED FINANCIAL STATEMENTS
as of January 1, 1996 (assumed date of inception)
and for the fifteen years ending December 31, 2010

VENTURE CAPITAL MARKETING ASSOCIATION
(A Proposed Government Sponsored Enterprise)

PROJECTED FINANCIAL STATEMENTS
as of January 1, 1996 (assumed date of inception)
and for the fifteen years ending December 31, 2010

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Coopers
&Lybrand

Coopers & Lybrand L.L.P.

a professional services firm

ACCOUNTANTS' COMPILATION REPORT

The Board of Governors
National Association of Small Business Investment Companies

We have compiled the accompanying projected balance sheets and the related projected statements of income and retained earnings and cash flow of the Venture Capital Marketing Association (Vickie Mae), a Government Sponsored Enterprise (GSE) proposed by the National Association of Small Business Investment Companies (NASBIC), as of January 1, 1996 (assumed date of inception), and for the fifteen years in the period ending December 31, 2010. The projections have been compiled in accordance with standards established by the American Institute of Certified Public Accountants (AICPA), except that the management of NASBIC has elected to present a projection period of fifteen years, which exceeds the projection period of three to five years specified by AICPA standards.

The accompanying projections and this report were prepared for the purpose of assisting Members of Congress, their staff and other United States Government officials in evaluating the proposal by NASBIC to establish a GSE to provide financing to small business investment companies and should not be used for any other purpose. Accordingly, the accompanying projections and this report should not be used or referred to in connection with any offering of securities by Vickie Mae or any other entity.

A compilation is limited to presenting in the form of projections information that is the representation of management and does not include evaluation of the support for the assumptions underlying the projections. We have not examined the projections and, accordingly, do not express an opinion or any other form of assurance on the accompanying statements or assumptions. Furthermore, even if Vickie Mae is established and becomes operational there will usually be differences between the projected and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

Coopers & Lybrand L.L.P.

New York, New York
June 15, 1995

VENTURE CAPITAL MARKETING ASSOCIATION
PROJECTED BALANCE SHEETS
(Dollars in thousands)

	Inception Jan. 1, 1996	Dec. 31 1996	Dec. 31 1997	Dec. 31 1998	Dec. 31 1999	Dec. 31 2000	Dec. 31 2001	Dec. 31 2002
ASSETS								
Participating Securities	$ 185,500	$ 476,000	$ 871,500	$ 1,278,140	$ 1,707,536	$ 1,949,008	$ 2,054,800	$ 2,013,436
Debentures	0	205,314	524,124	784,659	1,065,411	1,371,009	1,665,317	1,902,992
Allowance for Debenture Losses	0	0	0	0	0	0	(32,850)	(51,010)
Net Investment in SBICs	185,500	681,314	1,395,624	2,062,799	2,772,947	3,320,017	3,687,267	3,865,418
Cash	17,800	34,742	33,428	50,000	50,000	50,000	50,000	50,000
Deferred Underwriting Fees		2,944	6,875	10,575	14,425	17,285	19,426	20,805
Furniture, Fixtures and Equipment	2,200	2,640	3,080	3,520	3,960	4,400	4,840	5,280
Accumulated Depreciation	0	(220)	(484)	(792)	(1,144)	(1,540)	(1,980)	(2,464)
Total Assets	$ 205,500	$ 721,420	$ 1,438,523	$ 2,126,102	$ 2,840,188	$ 3,390,162	$ 3,759,553	$ 3,939,038
LIABILITIES AND EQUITY								
LIABILITIES								
Participating Security Certificates	$ 185,500	$ 476,000	$ 871,500	$ 1,358,257	$ 1,845,856	$ 2,139,679	$ 2,248,961	$ 2,159,021
Debenture Certificates	0	205,314	524,124	755,466	983,471	1,227,842	1,460,302	1,662,215
Deferred User Fees		11,776	27,501	42,301	57,700	69,141	77,704	83,219
Total Liabilities	185,500	693,090	1,423,125	2,156,023	2,887,027	3,436,661	3,786,967	3,904,455
EQUITY								
SBIC Shareholder Investment	20,000	25,915	34,380	45,140	57,940	69,415	80,210	90,155
Retained Earnings	0	2,415	(18,982)	(75,061)	(104,778)	(115,914)	(107,624)	(55,571)
Total Equity	20,000	28,330	15,398	(29,921)	(46,838)	(46,499)	(27,414)	34,584
Total Liabilities and Equity	$ 205,500	$ 721,420	$ 1,438,523	$ 2,126,102	$ 2,840,188	$ 3,390,162	$ 3,759,553	$ 3,939,038
Participating Securities SBICs								
Licenses at beginning of year	N/A	34	49	64	76	88	100	110
New Licenses	N/A	15	15	12	12	12	10	10
Maturing Licenses	N/A	0	0	0	0	0	0	0
Licenses at end of year	34	49	64	76	88	100	110	120
Debenture SBICs								
Licenses at beginning of year	N/A	15	30	45	57	69	81	91
New Licenses	N/A	15	15	12	12	12	10	10
Maturing Licenses	N/A	0	0	0	0	0	0	0
Licenses at end of year	15	30	45	57	69	81	91	101

See accompanying Summary of Significant Projection Assumptions and Accounting Policies and Schedules I to V

VENTURE CAPITAL MARKETING ASSOCIATION
PROJECTED BALANCE SHEETS (continued)
(Dollars in thousands)

	Dec. 31 2003	Dec. 31 2004	Dec. 31 2005	Dec. 31 2006	Dec. 31 2007	Dec. 31 2008	Dec. 31 2009	Dec. 31 2010
ASSETS								
Participating Securities	$1,941,958	$1,868,225	$1,774,109	$1,697,101	$1,683,769	$1,760,797	$1,923,275	$2,151,000
Debentures	2,111,509	2,342,317	2,500,204	2,554,400	2,649,230	2,760,332	2,904,619	3,007,103
Allowance for Debenture Losses	(41,686)	(44,920)	(48,896)	(47,089)	(44,598)	(43,565)	(45,266)	(60,526)
Net Investment in SBICs	4,011,781	4,163,622	4,225,418	4,204,412	4,288,401	4,477,564	4,782,628	5,097,577
Cash	50,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000
Deferred Underwriting Fees	21,569	21,903	22,312	22,327	22,429	23,112	24,371	26,262
Furniture, Fixtures and Equipment	5,720	6,160	6,600	7,040	7,480	7,920	8,360	8,800
Accumulated Depreciation	(2,992)	(3,564)	(4,180)	(4,620)	(5,060)	(5,500)	(5,940)	(6,380)
Total Assets	$4,086,079	$4,238,121	$4,300,149	$4,279,159	$4,363,250	$4,553,096	$4,839,419	$5,176,258
LIABILITIES AND EQUITY								
LIABILITIES								
Participating Security Certificates	$2,030,402	$1,699,694	$1,736,566	$1,592,763	$1,515,269	$1,532,334	$1,641,899	$1,824,181
Debenture Certificates	1,857,161	2,066,369	2,202,164	2,237,845	2,310,915	2,394,383	2,484,894	2,564,509
Deferred User Fees	86,278	87,613	89,247	89,308	89,716	92,446	97,484	105,046
Total Liabilities	3,973,840	4,053,679	4,029,977	3,919,916	3,915,900	4,019,162	4,224,277	4,493,736
EQUITY								
SBIC Shareholder Investment	99,505	108,515	117,185	125,835	135,335	146,235	158,535	172,235
Retained Earnings	12,734	75,930	152,988	233,408	312,015	387,698	456,607	510,287
Total Equity	112,239	184,445	270,173	359,243	447,350	533,933	615,142	682,522
Total Liabilities and Equity	$4,086,079	$4,238,121	$4,300,149	$4,279,159	$4,363,250	$4,553,096	$4,839,419	$5,176,258
Participating Securities SBICs								
Licenses at beginning of year	120	130	140	150	160	161	166	171
New Licenses	10	10	10	10	20	20	20	20
Maturing Licenses	0	0	0	0	19	15	15	15
Licenses at end of year	130	140	150	160	161	166	171	176
Debenture SBICs								
Licenses at beginning of year	101	111	121	131	140	149	158	168
New Licenses	10	10	10	15	15	15	15	15
Maturing Licenses	0	0	0	6	6	6	5	5
Licenses at end of year	111	121	131	140	149	158	168	178

See accompanying Summary of Significant Projection Assumptions and Accounting Policies and Schedules I to V

VENTURE CAPITAL MARKETING ASSOCIATION
PROJECTED STATEMENTS OF INCOME AND RETAINED EARNINGS
(Dollars in thousands)

	1996	1997	1998	1999	2000	2001	2002
INVESTMENT REVENUE							
Prioritized Payments on Participating Securities	0	0	$362	$60,617	$101,157	$158,732	$193,683
Profit Participation on Participating Securities	0	0	0	0	1,259	6,887	18,286
Tax Distributions on Participating Securities	0	0	0	0	929	4,879	12,805
Interest Income on Debentures	$10,933	$38,843	69,693	98,516	129,739	159,498	186,617
Provision for Losses on Debentures	0	0	0	0	0	(32,850)	(51,010)
Amortization of Leverage User Fees	620	2,132	3,963	5,970	8,011	9,907	11,691
Interest Income on Idle Cash	712	1,390	1,337	2,000	2,000	2,000	2,000
Total Investment Revenue	12,265	42,365	75,355	167,103	243,095	309,052	374,073
FINANCING EXPENSE							
Interest Expense on Particapting Security Certificates	(28,114)	(57,269)	(94,765)	(136,175)	(169,385)	(186,517)	(187,339)
Interest Expense on Debenture Certificates	(8,623)	(30,638)	(53,743)	(73,035)	(97,875)	(112,902)	(131,146)
Amortization of Underwriting Fees for Certificate Issuance	(155)	(533)	(991)	(1,493)	(2,003)	(2,477)	(2,923)
Total Financing Expense	(36,892)	(88,438)	(149,498)	(210,703)	(264,263)	(301,896)	(321,408)
Net Investment Income (Loss)	(24,627)	(46,074)	(74,143)	(43,599)	(21,168)	7,156	52,665
OTHER INCOME (EXPENSE)							
Portfolio Management Fees	34,013	29,377	24,472	20,650	17,178	8,713	7,377
Licensing Fees	300	300	240	240	240	200	200
Examination Fees	1,205	1,355	1,475	1,595	1,715	1,815	1,915
Examination Costs	(1,205)	(1,355)	(1,475)	(1,595)	(1,715)	(1,815)	(1,915)
General and Administrative Expenses	(5,750)	(6,038)	(6,339)	(6,656)	(6,989)	(7,339)	(7,706)
Depreciation	(220)	(264)	(308)	(352)	(396)	(440)	(484)
Total Other Income (Expense)	28,343	23,376	16,064	13,882	10,033	1,134	(612)
Income (Loss) before Taxes	3,716	(22,698)	(56,079)	(29,717)	(11,136)	8,290	52,053
Income Taxes	(1,300)	1,300	0	0	0	0	0
Net Income (Loss)	2,415	(21,397)	(56,079)	(29,717)	(11,136)	8,290	52,053
Retained Earnings							
Beginning of year	0	2,415	(18,982)	(75,061)	(104,778)	(115,914)	(107,624)
Dividends	0	0	0	0	0	0	0
End of Year	$2,415	($18,982)	($75,061)	($104,778)	($115,914)	($107,624)	($55,571)

See accompanying Summary of Significant Projection Assumptions and Accounting Policies and Schedules I to V

VENTURE CAPITAL MARKETING ASSOCIATION
PROJECTED STATEMENTS OF INCOME AND RETAINED EARNINGS (continued)
(Dollars in thousands)

	2003	2004	2005	2006	2007	2008	2009	2010
INVESTMENT REVENUE								
Prioritized Payments on Participating Securities	$206,008	$207,732	$214,629	$204,045	$190,715	$180,545	$172,986	$168,509
Profit Participation on Participating Securities	24,942	28,121	32,338	31,648	28,383	26,536	24,675	23,535
Tax Distributions on Participating Securities	17,455	19,699	22,653	22,184	19,904	18,610	17,307	16,506
Interest Income on Debentures	210,997	234,178	254,610	266,023	274,125	285,159	297,581	309,705
Provision for Losses on Debentures	(41,686)	(44,920)	(48,896)	(47,089)	(44,598)	(43,565)	(45,266)	(60,526)
Amortization of Leverage User Fees	13,373	15,012	16,748	17,948	18,270	18,431	18,668	19,147
Interest Income on Idle Cash	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000
Total Investment Revenue	433,090	461,820	494,081	496,759	488,798	487,715	487,950	478,877
FINANCING EXPENSE								
Interest Expense on Particapting Security Certificates	(178,050)	(187,029)	(154,628)	(141,581)	(132,091)	(129,523)	(134,905)	(147,308)
Interest Expense on Debenture Certificates	(147,814)	(164,788)	(179,278)	(186,480)	(191,048)	(197,822)	(204,930)	(212,075)
Amortization of Underwriting Fees for Certificate Issuance	(3,343)	(3,753)	(4,187)	(4,487)	(4,567)	(4,608)	(4,667)	(4,787)
Total Financing Expense	(329,207)	(335,570)	(338,092)	(332,549)	(327,707)	(331,753)	(344,501)	(364,170)
Net Investment Income (Loss)	103,882	128,249	155,989	164,210	161,091	155,962	143,448	114,706
OTHER INCOME (EXPENSE)								
Portfolio Management Fees	5,970	4,149	1,535	0	0	0	0	0
Licensing Fees	200	200	200	250	350	350	350	350
Examination Fees	2,015	2,115	2,215	2,340	2,515	2,690	2,865	3,040
Examination Costs	(2,015)	(2,115)	(2,215)	(2,340)	(2,515)	(2,690)	(2,865)	(3,040)
General and Administrative Expenses	(8,091)	(8,495)	(8,920)	(9,366)	(9,834)	(10,326)	(10,842)	(11,385)
Depreciation	(528)	(572)	(616)	(440)	(440)	(440)	(440)	(440)
Total Other Income (Expense)	(2,449)	(4,719)	(7,801)	(9,556)	(9,924)	(10,416)	(10,932)	(11,475)
Income (Loss) before Taxes	101,433	121,531	148,188	154,654	151,167	145,546	132,516	103,232
Income Taxes	(16,052)	(42,536)	(51,866)	(54,129)	(52,908)	(50,941)	(46,381)	(36,131)
Net Income (Loss)	85,382	78,995	96,322	100,525	98,258	94,605	86,135	67,101
Retained Earnings								
Beginning of year	(55,571)	12,734	75,930	152,988	233,408	312,015	387,698	456,607
Dividends	(17,076)	(15,799)	(19,264)	(20,105)	(19,652)	(18,921)	(17,227)	(13,420)
End of Year	$12,734	$75,930	$152,988	$233,408	$312,015	$387,698	$456,607	$510,287

See accompanying Summary of Significant Projection Assumptions and Accounting Policies and Schedules I to V

VENTURE CAPITAL MARKETING ASSOCIATION
PROJECTED STATEMENTS OF CASH FLOW
(Dollars in thousands)

	1996	1997	1998	1999	2000	2001	2002
Net Income	$2,415	($21,397)	($56,079)	($29,717)	($11,136)	$8,290	$52,053
Increase (Decrease) in Deferred User Fees	11,778	15,725	14,800	15,399	11,441	8,563	5,515
Decrease (Increase) in Deferred Underwriting Fees	(2,944)	(3,031)	(3,700)	(3,850)	(2,860)	(2,141)	(1,379)
Provision for Losses on Debentures	0	0	0	0	0	32,850	51,010
Depreciation	220	264	308	352	396	440	484
Cash From Operations	11,467	(9,339)	(44,671)	(17,816)	(2,159)	48,003	107,683
Investments in Participating Securities	(290,500)	(395,500)	(490,000)	(574,000)	(472,500)	(444,500)	(409,500)
Returns of Capital - Participating Securities	0	0	83,360	144,604	231,029	338,708	450 864
Investments in Debentures	(205,314)	(318,810)	(260,535)	(280,752)	(305,598)	(294,308)	(278,738)
Debenture Repayments	0	0	0	0	0	0	8,213
Capital Expenditures	(440)	(440)	(440)	(440)	(440)	(440)	(440)
Cash From Investing	(496,254)	(714,750)	(667,815)	(710,588)	(547,509)	(400,540)	(229,601)
Issuance of Participating Security Certificates	290,500	395,500	490,000	574,000	472,500	444,500	409,500
Issuance of Debenture Certificates	205,314	318,810	260,535	280,752	305,598	294,308	278,738
Scheduled Repayments - Participating Security Certificates	0	0	0	0	0	0	0
Scheduled Repayments - Debenture Certificates	0	0	0	0	0	0	0
SBIC Shareholders' Equity Investment	5,915	8,465	10,760	12,800	11,475	10,795	9,945
Dividends	0	0	0	0	0	0	0
Cash From Financing before Prepayments	501,729	722,775	781,295	867,552	789,573	749,603	698,183
Prepayments of Participating Security Certificates	0	0	(3,243)	(86,400)	(178,677)	(335,218)	(499 440)
Prepayments of Debenture Certificates	0	0	(29,193)	(52,747)	(61,227)	(61,847)	(76,825)
Cash From Financing after Prepayments	501,729	722,775	728,858	728,405	549,668	352,538	121,918
Increase (Decrease) in Cash	16,942	(1,314)	16,572	0	0	(0)	(0)
Cash at Beginning of Year	17,800	34,742	33,428	50,000	50,000	50,000	50,000
Cash at End of Year	$34,742	$33,428	$50,000	$50,000	$50,000	$50,000	$50,000

See accompanying Summary of Significant Projection Assumptions and Accounting Policies and Schedules I to V

VENTURE CAPITAL MARKETING ASSOCIATION
PROJECTED STATEMENTS OF CASH FLOW (continued)
(Dollars in thousands)

	2003	2004	2005	2006	2007	2008	2009	2010
Net Income	$85,382	$78,995	$96,322	$100,525	$98,258	$94,605	$86,135	$67,101
Increase (Decrease) in Deferred User Fees	3,059	1,336	1,634	61	408	2,730	5,038	7,562
Decrease (Increase) in Deferred Underwriting Fees	(765)	(334)	(408)	(15)	(102)	(683)	(1,259)	(1,891)
Provision for Losses on Debentures	41,688	44,920	48,896	47,069	44,598	43,565	45,266	60,526
Depreciation	528	572	616	440	440	440	440	440
Cash From Operations	129,889	125,489	147,059	148,100	143,602	140,657	135,620	133,738
Investments in Participating Securities	(385,000)	(371,000)	(357,000)	(350,000)	(385,000)	(455,000)	(525,000)	(595,000)
Returns of Capital - Participating Securities	456,478	446,733	449,116	427,008	398,332	377,972	362,522	367,275
Investments in Debentures	(272,279)	(282,915)	(378,289)	(370,363)	(362,120)	(391,451)	(423,222)	(473,375)
Debenture Repayments	12,752	10,421	175,481	267,272	220,200	235,751	255,370	305,625
Capital Expenditures	(440)	(440)	(440)	(440)	(440)	(440)	(440)	(440)
Cash From Investing	(188,489)	(197,201)	(111,132)	(26,523)	(129,027)	(233,168)	(330,770)	(395,915)
Issuance of Participating Security Certificates	385,000	371,000	357,000	350,000	385,000	455,000	525,000	595,000
Issuance of Debenture Certificates	272,279	282,915	378,289	370,363	362,120	391,451	423,222	473,375
Scheduled Repayments - Participating Security Certificates	0	0	0	0	0	0	0	0
Scheduled Repayments - Debenture Certificates	0	0	0	0	0	0	0	0
SBIC Shareholders' Equity Investment	9,350	9,010	8,670	8,650	9,500	10,900	12,300	13,700
Dividends	(17,076)	(15,799)	(19,264)	(20,105)	(19,652)	(18,921)	(17,227)	(13,420)
Cash From Financing before Prepayments	649,553	647,126	724,694	708,908	736,969	838,430	943,295	1,068,655
Prepayments of Participating Security Certificates	(513,620)	(501,708)	(518,128)	(495,803)	(462,493)	(437,836)	(415,435)	(412,718)
Prepayments of Debenture Certificates	(77,334)	(73,707)	(242,494)	(334,682)	(289,050)	(307,983)	(332,710)	(393,760)
Cash From Financing after Prepayments	58,600	71,712	(35,926)	(121,577)	(14,575)	92,511	195,150	262,176
Increase (Decrease) in Cash	0	0	0	0	0	(0)	0	0
Cash at Beginning of Year	50,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000
Cash at End of Year	$50,000	$50,000	$50,000	$50,000	$50,000	$50,000	$50,000	$50,000

See accompanying Summary of Significant Projection Assumptions and Accounting Policies and Schedules I to V

VENTURE CAPITAL MARKETING ASSOCIATION
(A Proposed Government Sponsored Enterprise)

SUMMARY OF SIGNIFICANT PROJECTION ASSUMPTIONS
AND ACCOUNTING POLICIES
as of January 1, 1996 (assumed date of Inception)
and for the fifteen years ending December 31, 2010

1. Business and Organization

These financial projections for the Venture Capital Marketing Association (Vickie Mae), a Government Sponsored Enterprise (GSE) proposed by the National Association of Small Business Investment Companies (NASBIC) to be established to provide financing to investors in small businesses, present, to the best of NASBIC management's knowledge and belief, the expected assets and liabilities, results of operations and cash flows of Vickie Mae for the fifteen years following the inception of Vickie Mae, which is assumed to be January 1. 1996 (Inception). Accordingly, the financial projections reflect NASBIC management's judgment as of June 15, 1995, the date of these projections, of the expected conditions and management's courses of action, assuming that Vickie Mae is established and becomes operational as of January 1, 1996.

This presentation has been solely prepared to assist Members of Congress, their staff and other United States Government officials in evaluating NASBIC's proposal to establish a GSE such as Vickie Mae. Accordingly, this presentation should not be used for other purposes, such as evaluating a potential offering of securities of Vickie Mae.

The assumptions and accounting policies described below are those which management believes are significant to the projections. There will usually be differences between projected and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material.

Vickie Mae is a GSE proposed to be formed for the purpose of providing financing (leverage) to Small Business Investment Companies (SBICs) that have been granted licenses by the Small Business Administration (SBA) prior to Inception and by Vickie Mae after Inception. Vickie Mae will invest in both debentures and participating securities of the SBICs.

Except as specifically noted below, the projections assume that after Inception Vickie Mae's criteria for licensing SBICs, and the terms of the debentures and participating securities issued by SBICs, will be similar to those provided for by the Small Business Investment Act of 1958 (the 1958 Act), as amended by the Small Business Equity Enhancement Act of 1992 (the 1992 Act). The 1958 Act and the 1992 Act and related regulations issued thereunder are collectively referred to as the Regulations.

2. Capitalization and Financing

The initial shareholders of Vickie Mae will be licensed SBICs. The projections assume that the shareholders will contribute $20.0 million of equity capital to Vickie Mae at Inception. The projections also assume that licensed SBICs will contribute additional equity capital equal to 1.0% of the private capital and leverage invested in such SBICs after Inception. The projections assume that after 1996 Vickie Mae will pay dividends to its shareholders of 20% of net income, provided that Vickie Mae has positive retained earnings and that payment of the dividends will not require Vickie Mae to incur additional borrowing.

VENTURE CAPITAL MARKETING ASSOCIATION
SUMMARY OF SIGNIFICANT PROJECTION ASSUMPTIONS
AND ACCOUNTING POLICIES (continued)

The debentures and participating securities of SBICs in which Vickie Mae invests will be placed in separate pools, and Vickie Mae will issue certificates of interest in each pool in the bond market. The proceeds from the issuance of the certificates will be used to finance Vickie Mae's investments in such debentures and participating securities. Certificates of interest in the pools of participating securities and debentures are referred to collectively as Certificates and, respectively, as Participating Security Certificates and Debenture Certificates.

The projections assume that at Inception the SBA will transfer to Vickie Mae the rights to the cash flow from $185.5 million of outstanding participating securities of SBICs licensed by the SBA prior to Inception; and Vickie Mae will assume an obligation to the SBA to fund principal and interest payments on an equivalent amount of trust certificates issued by the SBA to finance its investment in such participating securities.

3. Terms of Vickie Mae Certificates

Vickie Mae Certificates are assumed to be issued at fixed rates of interest with various maturities of no more than ten years from the date of issuance. The projections assume that Certificates with less than ten-year maturity may be refinanced and, accordingly, the projections do not assume any scheduled repayments of Certificates prior to ten years after original issuance. The projections assume that Vickie Mae Certificates will be callable at face value beginning three years after issuance. On the basis of the assumptions reflected in the projections, all Certificates will be repaid prior to ten years after original issuance.

The projections assume that the market rate of interest on Certificates with a ten-year maturity will be the rate on U.S. Treasury obligations of ten-year maturity, plus 0.75% for Participating Security Certificates and plus 0.65% for Debenture Certificates. The projections assume that the ten-year U.S. Treasury rate will be 8.0% throughout the projection period. The projections assume that the effective weighted average interest rate on the Certificates will be 0.25% less than the rate for Certificates with a ten-year maturity, as a result of financing a portion of the participating securities and debentures with Certificates of less than ten-year maturity. The projections assume that only interest will payable prior to maturity of the Certificates.

The projections assume that Vickie Mae will pay a one-time underwriting fee of 0.625% of Certificates' face value when originally issued. The projections do not assume any additional underwriting fees in connection with the refinancing of Certificates with less than ten-year maturity.

4. Terms of Participating Securities

The projections assume that the participating securities mature ten years from the date of issuance and earn a prioritized return equal to the interest rate on Participating Security Certificates with ten-year maturity, plus 1.0%. This is a change from the Regulations, which provide for a prioritized return equal to the interest rate on the Participating Security Certificates issued to finance the investment in the participating securities.

The prioritized return accumulates from the date of issuance of the participating securities. SBICs are obligated to make payments of the accumulated prioritized return to Vickie Mae only

VENTURE CAPITAL MARKETING ASSOCIATION
SUMMARY OF SIGNIFICANT PROJECTION ASSUMPTIONS
AND ACCOUNTING POLICIES (continued)

out of available cash and only to the extent of accumulated undistributed earnings. Accumulated unpaid prioritized payments compound at the same rate as the prioritized return.

The projections assume that at the date of issuance SBICs will pay Vickie Mae a one-time user fee of 2.5% of the face value of participating securities issued. This is a change from the Regulations, which provide that a user fee of 2.0% be paid to the SBA.

5. Terms of Debentures

Debentures mature ten years from date of issuance and bear interest equal to the interest rate on Debenture Certificates with ten-year maturity, plus 2.0%. This is a change from the Regulations, which provide for interest on the debentures equal to the interest rate on Debenture Certificates issued to finance the investment in the debentures.

The projections assume that at the date of issuance SBICs will pay Vickie Mae a one-time user fee of 2.5% of the face value of debentures issued. This is a change from the Regulations, which provide that a user fee of 2.0% be paid to the SBA.

Prior to maturity, only interest is payable on the debentures. The projections assume that debentures may be refinanced at maturity for one additional ten-year term.

6. Levels of Investment - Participating Securities

The projections assume that as of December 31, 1994, 19 SBICs were licensed to issue participating securities and that the SBA will license 15 additional SBICs in 1995. The projections assume that after inception, the number of SBICs licensed to issue participating securities will be as follows: 15 each year in 1996 and 1997, 12 each year in 1998 through 2000, 10 each year in 2001 through 2006, and 20 each year thereafter throughout the remainder of the projection period. The assumptions regarding the number of SBICs licensed to issue participating securities are presented on the face of the projected balance sheets.

The projections assume that $20.0 million of private capital has been or will be committed to each SBIC that is licensed to issue participating securities. The projections also assume that the 19 SBICs licensed as of December 31, 1994 will invest 20.0% of their committed private capital each calendar year for 5 years beginning in 1995, and that SBICs licensed after December 31, 1994 will invest their committed private capital in calendar years as follows:

Year 1 (calendar year of licensure)	10.0%
Year 2	20.0%
Year 3	20.0%
Year 4	20.0%
Year 5	20.0%
Year 6	10.0%

The projections employ a mid-year convention under which it is assumed that the SBICs will invest private capital as of June 30, beginning in the calendar year of licensure, and will concurrently issue $1.75 of participating securities for every $1 of private capital invested.

VENTURE CAPITAL MARKETING ASSOCIATION
SUMMARY OF SIGNIFICANT PROJECTION ASSUMPTIONS AND ACCOUNTING POLICIES (continued)

7. Levels of Investment - Debentures

The projections assume that performing debentures with a face value of $894 million and debentures in default or liquidation with a face value of $600 million are outstanding at Inception. The projections assume that these debentures will not be acquired by Vickie Mae, but that Vickie Mae will be responsible for collecting the principal and interest on such debentures on behalf of the SBA, for which the SBA will pay Vickie Mae a portfolio management fee as described below in Note 10.

The projections assume that the SBA will license 15 SBICs to issue debentures in 1995 and that after Inception the number of SBICs licensed to issue debentures will be as follows: 15 each year in 1996 and 1997, 12 each year in 1998 through 2000, 10 each year in 2001 through 2005, and 15 each year thereafter throughout the remainder of the projection period. The assumptions regarding the number of SBICs licensed to issue debentures after December 31, 1994 are presented on the face of the projected balance sheets.

The projections assume that $10.0 million of private capital will be committed to each SBIC that is licensed to issue debentures after December 31, 1994. The projections assume that these SBICs will invest the same percentages of their committed private capital each year as SBICs licensed to issue participating securities, and the projections employ the same mid-year convention regarding the timing of the investment. The projections assume that SBICs licensed to issue debentures will issue $2 of debentures for every $1 of private capital invested.

In addition, the projections assume that in each of 1996 and 1997 Vickie Mae will invest $75.0 million in debentures issued by SBICs licensed prior to December 31, 1994.

The projections assume that 60% of the debentures, including the performing debentures outstanding at Inception, will be refinanced, rather than repaid at maturity. Vickie Mae will invest in the new debentures that replace those being refinanced.

8. Performance - Participating Securities

The projections classify the SBICs licensed to issue participating securities into six representative categories, with assumed net returns to all investors, including Vickie Mae, after user fees, management fees and operating costs, ranging from 23.7% to negative 4.4% for SBICs licensed as of December 31, 1994 and from 22.7% to negative 5.1% for SBICs licensed thereafter. The assumed weighted average net return is 11.0% for SBICs licensed as of December 31, 1994, and 10.6% for SBICs licensed thereafter. The projections assume that the SBICs' investments in Vickie Mae equity will earn a return equivalent to the weighted average net return on other investments. Accordingly, the projections assume that net returns do not require adjustment for the assumption that SBICs will invest 1% of their capital in Vickie Mae equity.

The assumptions regarding the weighting factor for each category of SBIC and each category's net returns and cash distributions are presented in Schedule I for SBICs licensed as of December 31, 1994 and in Schedule II for SBICs licensed thereafter.

VENTURE CAPITAL MARKETING ASSOCIATION
SUMMARY OF SIGNIFICANT PROJECTION ASSUMPTIONS AND ACCOUNTING POLICIES (continued)

According to the 1994 Investment Benchmark Report published by Venture Economics (the 1994 IBR), the capital weighted net returns to limited partners for venture capital investment companies formed in 1976 through 1989 were 8.6% for a sample of 84 companies with $50 to $100 million in capital and 9.0% for a sample of 212 balanced stage companies. After adjusting the returns reported in the 1994 IBR to eliminate the effects of an assumed 20.0% general partners' carried interest, capital weighted net returns to all investors were 10.75% for companies with $50 to $100 million of capital and 11.25% for balanced stage companies. Management believes that SBICs licensed to issue participating securities will generally have a balanced stage investment strategy and capital, including participating securities, of at least $50 million.

The projections assume that the SBICs will begin to make cash distributions in the fourth year after the date of issuance of the participating securities. The projections assume that distributions will be made on December 31 within the year after the date of issuance for which the distribution is assumed. Schedule III presents, for SBICs licensed after December 31, 1994, the assumed ratios of cumulative distributions to investments for all investors and for Vickie Mae separately. Distributions from the SBICs to Vickie Mae have been determined in accordance with the Regulations, modified as noted above, based on the SBICs assumed net returns.

Schedule III also presents for comparison the ratios of limited partners' cumulative distributions to investments for a sample of 403 venture capital investment companies that were formed during the years 1969 through 1989, as reported in the 1994 IBR. The ratios have not been adjusted to eliminate the effects of general partners' carried interests.

9. Performance - Debentures

The projections assume that 20% of debentures will default on interest payments and be placed in liquidation in the sixth year after the date of issuance. The projections assume that 20% of the principal of debentures placed in liquidation will be collected in the seventh year after the date of issuance.

10. Portfolio Management Fees

The projections assume that the SBA or its successor will pay Vickie Mae an annual management fee of 2% of the average remaining balance of debentures that were outstanding at Inception. Vickie Mae will not be entitled to a management fee on debentures that refinance debentures outstanding at Inception.

The projections assume that the SBA will also pay Vickie Mae an incentive fee of 10% of amounts collected on debentures that were in default or in liquidation at Inception. The projections assume that 50% of the principal amount of such debentures will be collected in total, and that collections will occur in equal amounts in each of the first five years following Inception.

VENTURE CAPITAL MARKETING ASSOCIATION
SUMMARY OF SIGNIFICANT PROJECTION ASSUMPTIONS
AND ACCOUNTING POLICIES (continued)

11. Cash Management

Vickie Mae is assumed to pay interest currently on Participating Securities Certificates, while distributions from the underlying participating securities are assumed to begin four years after issuance. Accordingly, cash received by Vickie Mae from SBIC equity capital contributions, distributions on participating securities, interest on debentures, management fees and other sources may not be sufficient to pay interest on the Certificates and current operating expenses, particularly in the first years following Inception. In such a case, it is assumed that Vickie Mae will finance cash requirements with short-term borrowings at interest rates equivalent to the rate on U.S. Treasury obligations of three-year maturity, plus 0.50%. On the basis of the assumptions reflected in the projections, no short-term borrowings are required.

To the extent that Vickie Mae has excess cash, the projections assume that Vickie Mae will maintain a cash balance at year end of $50 million. The projections assume that cash available in excess of the assumed year-end balance will be used to redeem Certificates called by Vickie Mae prior to maturity. Redemptions are allocated between Participating Security Certificates and Debenture Certificates on the basis of the cash flow attributable to the participating security and debenture segments of Vickie Mae. Summarized projected income and cash flow statements for the participating security and debenture segments of Vickie Mae are presented in Schedules IV and V, respectively.

The projections assume that idle cash will earn interest at the rate of 4% per year.

12. Operating Revenue and Expenses

The projections assume that Vickie Mae will charge license applicants a nonrefundable application fee of $5,000. The projections assume that one-half of applicants will be granted licenses as SBICs.

The projections assume that Vickie Mae will charge all licensed SBICs an annual examination fee of $5,000, equal to Vickie Mae's cost of performing such examinations.

The projections assume that Vickie Mae's general and administrative expenses in the first year after Inception will be $5.75 million, approximately equal to the current budget of the Investment Division of the SBA. The projections assume that the amount of such expenses will grow at 5% annually throughout the projection period.

13. Capital Expenditures

The projections assume that capital expenditures for furniture, computers and other office equipment, and leasehold improvements required at Inception will be $2.2 million. After Inception, the projections assume that annual capital expenditures will be $440,000 throughout the projection period.

The projections assume that fixed assets are depreciated over ten years using the straight line method.

VENTURE CAPITAL MARKETING ASSOCIATION
SUMMARY OF SIGNIFICANT PROJECTION ASSUMPTIONS AND ACCOUNTING POLICIES (continued)

14. Accounting Policies

The accompanying projections have been prepared using the accrual method of accounting in accordance with generally accepted accounting principles. Significant accounting policies are described below.

Revenue from prioritized returns on participating securities of SBICs is recognized when received in cash, because SBICs are not obligated to make prioritized payments except from undistributed earnings, which can not be assured.

User fees received from SBICs in connection with Vickie Mae's investments in participating securities and debentures are deferred and recognized as revenue using the straight line method over ten years, the maturity period of the participating securities and debentures.

Underwriting fees paid in connection with the issuance of Certificates are deferred and recognized as expense using the straight line method over ten years, the effective maturity of the Certificates.

The use of the straight line method for recognizing user fee revenue and underwriting fee expense does not yield a materially different net result from use of the interest or effective yield method.

A provision for losses on debentures, net of assumed recoveries, is accrued at the time when such losses are probable and estimable, which is assumed to be in the year of default on interest payments.

15. Income Taxes

The projections assume that all SBICs will be organized in the form of limited partnerships and, accordingly, will not be subject to income taxes. The projections assume that Vickie Mae will be subject to U.S. federal but not state and local income taxes. The projections assume that the effective U.S. federal income tax rate is 35% and that there are no differences between income reported for financial reporting purposes and tax purposes.

The projections assume use of net operating loss (NOL) carrybacks and carryforwards. The tax benefits of NOL carryforwards are recognized in the projections when realized for tax purposes.

VENTURE CAPITAL MARKETING ASSOCIATION
PARTICIPATING SECURITY SBICs LICENSED AS OF DECEMBER 31, 1994
INTERNAL RATE OF RETURN (IRR) AND CASH DISTRIBUTION ASSUMPTIONS
(Dollars in thousands)

IRR Assumptions - All Investors	Weighting Factor	Net IRR
SBIC 1	2.9	23.1%
SBIC 2	2.9	16.7%
SBIC 3	3.8	14.3%
SBIC 4	7.6	5.3%
SBIC 5	1.0	0.6%
SBIC 6	1.0	-4.4%
Weighted Average Return	19.0	11.0%

	Weighting Factor	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12	Year 13	Total	Per SBIC
Distributions to Vickie Mae																
Prioritized Return - End of Year																
SBIC 1	2.9	0	0	0	$362	$24,311	$8,894	$5,817	$3,582	$2,173	$1,225	$729	$248	0	$47,341	$16,611
SBIC 2	2.9	0	0	0	0	18,164	18,411	6,145	4,052	1,634	919	547	186	0	48,057	16,862
SBIC 3	3.8	0	0	0	0	11,262	18,074	27,929	6,072	2,912	1,639	978	332	0	69,197	18,210
SBIC 4	7.6	0	0	0	0	0	0	20,754	35,278	28,596	17,576	18,196	8,653	0	129,052	16,980
SBIC 5	1.0	0	0	0	0	0	0	0	0	17	688	765	310	0	1,779	1,873
SBIC 6	1.0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Total		0	0	0	362	51,737	45,379	60,645	48,984	35,331	22,046	21,212	8,729	0	295,426	15,549
Average		0	0	0	19	2,723	2,388	3,192	2,578	1,860	1,160	1,118	512	0		
Tax Distribution - End of Year	Weighting Factor															
SBIC 1	2.9	0	0	0	0	0	764	1,829	2,998	2,560	1,830	1,864	994	0	12,837	4,504
SBIC 2	2.9	0	0	0	0	0	44	1,293	2,157	1,876	1,310	1,337	701	0	8,719	3,059
SBIC 3	3.8	0	0	0	0	0	0	217	1,935	1,691	1,156	1,201	621	0	6,821	1,795
SBIC 4	7.6	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
SBIC 5	1.0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
SBIC 6	1.0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Total		0	0	0	0	0	808	3,340	7,088	6,127	4,296	4,401	2,316	0	28,377	1,494
Average		0	0	0	0	0	43	176	373	322	228	232	122	0		
Profit Distribution - End of Year	Weighting Factor															
SBIC 1	2.9	0	0	0	0	0	1,074	2,617	4,306	3,675	2,618	2,666	1,424	0	18,380	6,449
SBIC 2	2.9	0	0	0	0	0	32	1,841	3,092	2,685	1,864	1,904	999	0	12,417	4,357
SBIC 3	3.6	0	0	0	0	0	0	272	2,760	2,406	1,631	1,696	877	0	8,643	2,538
SBIC 4	7.6	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
SBIC 5	1.0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
SBIC 6	1.0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Total		0	0	0	0	0	1,107	4,730	10,157	8,766	6,113	6,267	3,300	0	40,440	2,128
Average		0	0	0	0	0	58	249	535	461	322	330	174	0		
Return of Capital - End of Year	Weighting Factor															
SBIC 1	2.9	0	0	0	13,075	11,097	15,955	22,945	14,429	9,713	5,072	4,933	2,530	0	99,750	35,000
SBIC 2	2.9	0	0	0	11,802	12,332	12,625	21,486	24,817	7,286	3,804	3,700	1,898	0	99,750	35,000
SBIC 3	3.8	0	0	0	13,885	18,238	18,748	21,908	32,443	13,000	6,788	6,602	3,386	0	133,000	35,000
SBIC 4	7.6	0	0	0	21,242	34,653	40,282	43,632	49,671	33,409	17,445	16,966	8,701	0	266,000	35,000
SBIC 5	1.0	0	0	0	2,299	3,484	4,143	5,720	7,182	5,008	2,206	2,121	1,088	0	33,250	35,000
SBIC 6	1.0	0	0	0	1,975	2,733	3,353	4,540	5,592	3,703	1,797	1,705	944	0	26,343	27,729
Total		0	0	0	64,276	82,536	93,107	120,233	134,135	72,119	37,112	36,027	18,546	0	658,093	34,636
Average		0	0	0	3,383	4,344	4,900	6,328	7,060	3,796	1,953	1,896	976	0		
Total Average Distributions to Vickie Ma		0	0	0	3,402	7,067	7,390	9,945	10,546	6,439	3,661	3,574	1,784	0	53,807	
Vickie Mae Investments		($7,000)	($7,000)	($7,000)	(7,000)	(7,000)	0	0	0	0	0	0	0	0	(35,000)	
Net Cash Flow to Vickie Mae		(7,000)	(7,000)	(7,000)	(3,598)	67	7,390	9,945	10,546	6,439	3,661	3,574	1,784	0	18,807	
Vickie Mae IRR		10.32%														

Schedule I

VENTURE CAPITAL MARKETING ASSOCIATION
PARTICIPATING SECURITY SBICs LICENSED AFTER DECEMBER 31, 1994
INTERNAL RATE OF RETURN (IRR) AND CASH DISTRIBUTION ASSUMPTIONS
(Dollars in thousands)

IRR Assumptions - All Investors	Weighing Factor	Net IRR
SBIC 1	15	22.7%
SBIC 2	15	18.3%
SBIC 3	20	13.8%
SBIC 4	40	4.8%
SBIC 5	5	0.1%
SBIC 6	5	-5.1%
Weighted Average Return	100	10.6%

Distributions to Vickie Mae	Weighing Factor	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12	Year 13	Total	Per SBIC
Prioritized Return - End of Year																
SBIC 1	15	0	0	0	0	$41,710	$120,421	$36,414	$26,331	$13,054	$7,816	$5,128	$5,119	$5,119	$261,109	$17,407
SBIC 2	15	0	0	0	0	17,490	102,460	86,013	28,558	16,079	9,633	5,654	5,120	5,119	276,125	18,408
SBIC 3	20	0	0	0	0	0	89,772	132,164	108,585	25,549	11,330	6,837	6,825	6,825	387,886	19,394
SBIC 4	40	0	0	0	0	0	0	27,467	159,115	181,036	126,726	102,105	74,793	27,150	698,391	17,460
SBIC 5	5	0	0	0	0	0	0	0	0	0	970	4,225	2,968	685	8,846	1,769
SBIC 6	5	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Total		0	0	0	0	59,199	312,653	282,058	322,588	235,717	156,475	123,948	94,823	44,898	1,632,358	16,324
Average		0	0	0	0	592	3,127	2,821	3,226	2,357	1,565	1,239	948	449		
Tax Distribution - End of Year	Weighing Factor															
SBIC 1	15	0	0	0	0	0	802	6,928	13,228	15,886	12,377	10,455	7,878	3,248	70,803	4,720
SBIC 2	15	0	0	0	0	0	0	2,527	8,439	11,420	8,734	7,415	5,560	2,209	47,305	3,154
SBIC 3	20	0	0	0	0	0	0	0	5,190	10,255	7,951	6,695	4,952	1,858	36,900	1,845
SBIC 4	40	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
SBIC 5	5	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
SBIC 6	5	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Total		0	0	0	0	0	802	9,455	27,857	37,561	29,063	24,565	18,390	7,314	155,007	1,550
Average		0	0	0	0	0	8	95	279	376	291	246	184	73		
Profit Distribution - End of Year	Weighing Factor															
SBIC 1	15	0	0	0	0	0	1,012	9,873	18,994	22,843	17,763	14,979	11,248	4,624	101,336	6,756
SBIC 2	15	0	0	0	0	0	0	3,499	13,509	18,378	12,488	10,577	7,891	3,119	67,459	4,497
SBIC 3	20	0	0	0	0	0	0	0	7,302	14,636	11,301	9,482	6,958	2,582	52,261	2,613
SBIC 4	40	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
SBIC 5	5	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
SBIC 6	5	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Total		0	0	0	0	0	1,012	13,372	39,805	53,856	41,551	35,038	26,097	10,325	221,055	2,211
Average		0	0	0	0	0	10	134	398	539	416	350	261	103		
Return of Capital - End of Year	Weighing Factor															
SBIC 1	15	0	0	0	$26,948	50,891	73,882	103,501	136,264	53,502	33,050	22,862	16,572	7,529	525,000	35,000
SBIC 2	15	0	0	0	23,689	54,052	70,690	83,894	128,114	85,943	40,735	28,178	20,425	9,280	525,000	35,000
SBIC 3	20	0	0	0	27,574	72,135	98,081	97,054	143,509	145,841	47,835	33,089	23,985	10,897	700,000	35,000
SBIC 4	40	0	0	0	41,001	83,757	221,130	232,610	243,568	227,604	140,580	97,242	70,487	32,024	1,400,000	35,000
SBIC 5	5	0	0	0	4,353	9,052	23,000	25,282	34,206	33,624	20,426	12,241	8,813	4,003	175,000	35,000
SBIC 6	5	0	0	0	3,651	6,680	18,915	20,122	26,684	25,468	15,239	10,190	8,898	3,309	136,973	27,395
Total		0	0	0	127,216	286,566	505,697	562,464	712,343	552,002	297,865	203,801	146,977	67,041	3,461,973	34,620
Average		0	0	0	1,272	2,866	5,057	5,625	7,123	5,520	2,979	2,038	1,470	670		
Total Average Distributions to Vickie Me		0	0	0	1,272	3,458	8,202	8,673	11,026	8,791	5,250	3,874	2,863	1,296	54,704	
Vickie Mae Investments		($3,500)	($7,000)	($7,000)	(7,000)	(7,000)	(3,500)	0	0	0	0	0	0	0	(35,000)	
Net Cash Flow to Vickie Mae		(3,500)	(7,000)	(7,000)	(5,728)	(3,542)	4,702	8,673	11,028	8,791	5,250	3,874	2,863	1,296	19,704	
Vickie Mae IRR		10.30%														

Schedule II

VENTURE CAPITAL MARKETING ASSOCIATION
PARTICIPATING SECURITY SBICs LICENSED AFTER DECEMBER 31, 1994
RATIOS OF CUMULATIVE CASH DISTRIBUTION TO CASH INVESTMENTS

Distributions to Vickie Mee	Weighting Factor	Net IRR	Years After Inception 4	5	6	7	8	9	10	11	12	13
SBIC 1	15	22.7%	0.07	0.25	0.60	0.90	1.27	1.47	1.61	1.71	1.79	1.83
SBIC 2	15	16.3%	0.06	0.20	0.51	0.65	1.19	1.40	1.53	1.63	1.71	1.74
SBIC 3	20	13.8%	0.06	0.16	0.41	0.74	1.12	1.40	1.51	1.59	1.65	1.66
SBIC 4	40	4.8%	0.04	0.11	0.25	0.44	0.73	1.02	1.21	1.35	1.48	1.50
SBIC 5	5	0.1%	0.04	0.09	0.21	0.35	0.55	0.74	0.86	0.96	1.02	1.05
SBIC 6	5	-5.1%	0.03	0.07	0.17	0.28	0.43	0.58	0.67	0.73	0.76	0.78
Weighted Average			0.05	0.15	0.37	0.62	0.93	1.18	1.33	1.44	1.53	1.56

Distributions to all SBIC Investors	Weighting Factor	Net IRR	Years After Inception 4	5	6	7	8	9	10	11	12	13
SBIC 1	15	22.7%	0.07	0.22	0.50	0.86	1.41	2.01	2.44	2.79	3.06	3.17
SBIC 2	15	16.3%	0.06	0.19	0.43	0.74	1.19	1.67	2.01	2.28	2.48	2.57
SBIC 3	20	13.8%	0.06	0.16	0.38	0.62	1.00	1.38	1.65	1.86	2.01	2.07
SBIC 4	40	4.8%	0.04	0.11	0.25	0.43	0.68	0.92	1.08	1.20	1.28	1.32
SBIC 5	5	0.1%	0.04	0.09	0.21	0.35	0.55	0.74	0.86	0.95	1.01	1.03
SBIC 6	5	-5.1%	0.03	0.07	0.17	0.28	0.43	0.58	0.67	0.73	0.76	0.76
Weighted Average			0.05	0.14	0.33	0.57	0.81	1.28	1.61	1.70	1.83	1.89

Investment Benchmark Report 1994 -
Distributions to Limited Partners in 03 Venture Funds

Year of Fund Formation	Years After Inception 4	5	6	7	8	9	10	11	12	13
1969-75	0.10	0.10	0.20	0.30	1.30	2.00	2.80	3.50	4.40	4.50
1976-78	0.30	1.00	1.60	2.20	2.50	2.80	2.90	2.70	2.90	3.00
1980	0.32	0.49	0.67	0.97	1.16	1.31	1.46	1.59	1.70	1.80
1981	0.08	0.15	0.39	0.68	0.63	0.96	1.03	1.27	1.39	1.44
1982	0.06	0.13	0.26	0.37	0.53	0.66	0.68	0.95	1.08	
1983	0.05	0.10	0.23	0.35	0.53	0.70	0.67	1.06		
1984	0.07	0.14	0.24	0.37	0.54	0.69	0.69			
1985	0.05	0.13	0.21	0.53	0.71	0.90				
1986	0.06	0.11	0.20	0.41	0.60					
1987	0.05	0.11	0.21	0.46						
1988	0.10	0.21	0.42							
1989	0.07	0.16								
Average All Years	0.11	0.24	0.44	0.66	0.97	1.23	1.55	1.65	2.29	2.69
Average 1969-1984	0.14	0.31	0.54	0.78	1.08	1.27	1.55	1.66	2.29	2.69

Schedule III

VENTURE CAPITAL MARKETING ASSOCIATION
PARTICIPATING SECURITY SEGMENT
SUMMARIZED INCOME AND CASH FLOW STATEMENTS
(Dollars in thousands)

	1996	1997	1998	1999	2000	2001	2002
SUMMARIZED INCOME STATEMENTS							
Prioritized Payments	0	0	$382	$60,617	$101,157	$158,732	$193,683
Profit Participation	0	0	0	0	1,259	6,887	18,286
Tax Distributions	0	0	0	0	920	4,879	12,805
Amortization of Leverage User Fees	$363	$1,221	2,328	3,656	4,966	6,112	7,170
Interest Income on Idle Cash	356	695	689	1,000	1,000	1,000	1,000
Amortization of Underwriting Fees	(91)	(305)	(582)	(914)	(1,241)	(1,528)	(1,795)
Interest Expense on Certificates	(28,114)	(57,269)	(94,765)	(136,175)	(169,365)	(186,517)	(187,339)
Net Investment Income (Loss)	(27,485)	(55,658)	(91,989)	(71,815)	(61,317)	(10,436)	43,619
Licensing Fees	150	150	120	120	120	100	100
Examination Fees	245	320	380	440	500	550	600
Examination Costs	(245)	(320)	(380)	(440)	(500)	(550)	(600)
General & Administrative Expense Allocation	(2,675)	(3,019)	(3,170)	(3,328)	(3,495)	(3,669)	(3,853)
Depreciation Allocation	(110)	(132)	(154)	(176)	(198)	(220)	(242)
Income (Loss) before Taxes	(30,320)	(58,659)	(95,192)	(75,199)	(64,889)	(14,225)	39,825
Income Tax Allocation	0	0	0	0	0	0	0
Net Income (Loss)	($30,320)	($58,659)	($95,192)	($75,199)	($64,889)	($14,225)	$39,825
SUMMARIZED CASH FLOW STATEMENTS							
Net Income (Loss)	($30,320)	($58,659)	($95,192)	($75,199)	($64,889)	($14,225)	$39,825
Increase (Decrease) in Deferred User Fees	6,899	8,667	9,923	10,693	6,847	5,001	3,058
Decrease (Increase) in Deferred Underwriting Fees	(1,725)	(2,187)	(2,461)	(2,673)	(1,712)	(1,250)	(765)
Depreciation Allocation	110	132	154	176	198	220	242
Cash from Operations	(25,036)	(52,027)	(87,587)	(67,003)	(59,556)	(10,255)	42,360
Investments in Participating Securities	(290,500)	(395,500)	(490,000)	(574,000)	(472,500)	(444,500)	(409,500)
Returns of Capital - Participating Securities	0	0	83,360	144,604	231,029	338,708	450,864
Capital Expenditure Allocation	(220)	(220)	(220)	(220)	(220)	(220)	(220)
Cash from Investing	(290,720)	(395,720)	(406,860)	(429,616)	(241,691)	(106,012)	41,144
Certificate Issuance	290,500	395,500	490,000	574,000	472,500	444,500	409,500
SBIC Shareholders' Equity Investment	4,565	6,215	7,700	9,020	7,425	6,985	6,435
Scheduled Repayment of Certificates	0	0	0	0	0	0	0
Dividends	0	0	0	0	0	0	0
Cash from Financing before Prepayments	295,065	401,715	497,700	583,020	479,925	451,485	415,935
Prepayments of Certificates	0	0	(3,243)	(86,400)	(178,677)	(335,218)	(499,440)
Cash from Financing after Prepayments	295,065	401,715	494,457	496,620	301,248	116,267	(83,505)
Increase (Decrease) in Cash	($20,691)	($46,032)	$0	$0	$0	$0	$0

Schedule IV

VENTURE CAPITAL MARKETING ASSOCIATION
PARTICIPATING SECURITY SEGMENT
SUMMARIZED INCOME AND CASH FLOW STATEMENTS (continued)
(Dollars in thousands)

	2003	2004	2005	2006	2007	2008	2009	2010
SUMMARIZED INCOME STATEMENTS								
Prioritized Payments	$206,008	$207,732	$214,829	$204,045	$190,715	$180,545	$172,966	$168,508
Profit Participation	24,942	26,121	32,336	31,648	26,383	28,536	24,875	23,535
Tax Distributions	17,455	19,699	22,653	22,184	19,904	18,610	17,307	16,506
Amortization of Leverage User Fees	8,173	9,116	10,026	10,548	10,609	10,553	10,448	10,539
Interest Income on Idle Cash	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Amortization of Underwriting Fees	(2,043)	(2,279)	(2,507)	(2,837)	(2,652)	(2,638)	(2,812)	(2,835)
Interest Expense on Certificates	(176,050)	(167,028)	(154,626)	(141,581)	(132,091)	(129,523)	(134,905)	(147,308)
Net Investment Income (Loss)	77,484	96,361	123,513	125,206	115,867	105,091	88,899	70,146
Licensing Fees	100	100	100	100	200	200	200	200
Examination Fees	650	700	750	800	900	1,000	1,100	1,200
Examination Costs	(650)	(700)	(750)	(800)	(900)	(1,000)	(1,100)	(1,200)
General & Administrative Expense Allocation	(4,045)	(4,248)	(4,460)	(4,683)	(4,917)	(5,163)	(5,421)	(5,692)
Depreciation Allocation	(264)	(286)	(308)	(220)	(220)	(220)	(220)	(220)
Income (Loss) before Taxes	73,274	91,927	118,845	120,403	110,930	99,886	83,457	64,434
Income Tax Allocation	(11,596)	(32,175)	(41,596)	(42,141)	(38,825)	(34,964)	(29,210)	(22,552)
Net Income (Loss)	$61,679	$59,753	$77,249	$78,262	$72,104	$64,934	$54,247	$41,882
SUMMARIZED CASH FLOW STATEMENTS								
Net Income (Loss)	$61,679	$59,753	$77,249	$78,262	$72,104	$64,934	$54,247	$41,882
Increase (Decrease) in Deferred User Fees	1,453	156	(1,103)	(1,798)	(864)	823	2,878	4,336
Decrease (Increase) in Deferred Underwriting Fees	(363)	(39)	276	450	248	(206)	(669)	(1,084)
Depreciation Allocation	264	286	308	220	220	220	220	220
Cash from Operations	63,032	60,157	76,730	77,134	71,586	65,771	56,475	45,354
Investments in Participating Securities	(385,000)	(371,000)	(357,000)	(350,000)	(385,000)	(455,000)	(525,000)	(595,000)
Returns of Capital - Participating Securities	456,476	446,733	449,116	427,006	396,332	377,972	382,522	367,275
Capital Expenditure Allocation	(220)	(220)	(220)	(220)	(220)	(220)	(220)	(220)
Cash from Investing	71,256	75,513	91,896	76,786	13,112	(77,248)	(162,698)	(227,945)
Certificate Issuance	385,000	371,000	357,000	350,000	385,000	455,000	525,000	595,000
SBIC Shareholders' Equity Investment	6,050	5,830	5,610	5,500	6,050	7,150	6,250	9,350
Scheduled Repayment of Certificates	0	0	0	0	0	0	0	0
Dividends	(11,720)	(10,792)	(13,108)	(13,618)	(13,255)	(12,736)	(11,593)	(9,041)
Cash from Financing before Prepayments	379,330	366,038	349,502	341,882	377,795	449,414	521,657	595,309
Prepayments of Certificates	(513,620)	(501,708)	(518,128)	(495,803)	(462,493)	(437,936)	(415,435)	(412,718)
Cash from Financing after Prepayments	(134,290)	(135,670)	(168,626)	(153,921)	(84,699)	11,478	106,222	182,591
Increase (Decrease) in Cash	$0	$0	$0	$0	$0	$0	$0	$0

Schedule IV

VENTURE CAPITAL MARKETING ASSOCIATION
DEBENTURE SEGMENT
SUMMARIZED INCOME AND CASH FLOW STATEMENTS
(Dollars in thousands)

	1996	1997	1998	1999	2000	2001	2002
SUMMARIZED INCOME STATEMENTS							
Interest Income on Debentures	$10,933	$38,843	$69,693	$98,516	$129,739	$159,498	$186,617
Amortization of Leverage User Fees	257	912	1,636	2,313	3,046	3,795	4,512
Interest Income on Idle Cash	358	895	669	1,000	1,000	1,000	1,000
Provision for Losses	0	0	0	0	0	(32,850)	(51,010)
Interest Expense on Certificates	(8,623)	(30,638)	(53,743)	(73,035)	(92,875)	(112,902)	(131,146)
Amortization of Underwriting Fees	(64)	(228)	(409)	(576)	(761)	(949)	(1,128)
Net Investment Income (Loss)	2,858	9,585	17,645	26,215	40,146	17,592	8,846
Portfolio Management Fees	34,013	29,377	24,472	20,650	17,178	8,713	7,377
Licensing Fees	150	150	120	120	120	100	100
Examination Fees	980	1,035	1,095	1,155	1,215	1,265	1,315
Examination Costs	(980)	(1,035)	(1,095)	(1,155)	(1,215)	(1,265)	(1,315)
General & Administrative Expense Allocation	(2,875)	(3,019)	(3,170)	(3,328)	(3,495)	(3,669)	(3,853)
Depreciation Allocation	(110)	(132)	(154)	(176)	(198)	(220)	(242)
Income (Loss) before Taxes	34,036	35,962	39,113	45,481	53,754	22,515	12,228
Income Tax Allocation	(1,300)	1,300	0	0	0	0	0
Net Income (Loss)	$32,736	$37,262	$39,113	$45,481	$53,754	$22,515	$12,228
SUMMARIZED CASH FLOW STATEMENTS							
Net Income (Loss)	$32,736	$37,262	$39,113	$45,481	$53,754	$22,515	$12,228
Increase (Decrease) in Deferred User Fees	4,878	7,058	4,877	4,706	4,594	3,562	2,457
Decrease (Increase) in Deferred Underwriting Fees	(1,219)	(1,765)	(1,219)	(1,177)	(1,149)	(891)	(814)
Provision for Losses on Debentures	0	0	0	0	0	32,850	51,010
Depreciation Allocation	110	132	154	176	198	220	242
Cash from Operations	36,503	42,688	42,925	49,187	57,397	58,257	65,322
Investments in Debentures	(205,314)	(318,810)	(260,535)	(280,752)	(305,598)	(294,308)	(278,738)
Debenture Repayments	0	0	0	0	0	0	8,213
Capital Expenditure Allocation	(220)	(220)	(220)	(220)	(220)	(220)	(220)
Cash from Investing	(205,534)	(319,030)	(260,755)	(280,972)	(305,818)	(294,528)	(270,745)
Certificate Issuance	205,314	318,810	260,535	280,752	305,598	294,308	278,738
SBIC Shareholders' Equity Investment	1,350	2,250	3,060	3,780	4,050	3,810	3,510
Scheduled Repayment of Certificates	0	0	0	0	0	0	0
Dividends	0	0	0	0	0	0	0
Cash from Financing before Prepayments	206,664	321,060	263,585	284,532	309,648	298,118	282,248
Prepayments of Certificates	0	0	(29,183)	(52,747)	(61,227)	(61,847)	(76,825)
Cash from Financing after Prepayments	206,664	321,060	234,402	231,785	248,421	236,271	205,423
Increase (Decrease) in Cash	$37,633	$44,718	$18,572	$0	$0	$0	$0

Schedule V

VENTURE CAPITAL MARKETING ASSOCIATION
DEBENTURE SEGMENT
SUMMARIZED INCOME AND CASH FLOW STATEMENTS (continued)
(Dollars in thousands)

	2003	2004	2005	2006	2007	2008	2009	2010
SUMMARIZED INCOME STATEMENTS								
Interest Income on Debentures	$210,997	$234,176	$254,610	$268,023	$274,125	$285,159	$297,561	$309,705
Amortization of Leverage User Fees	5,200	5,884	6,721	7,400	7,661	7,878	8,220	8,608
Interest Income on Idle Cash	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Provision for Losses	(41,886)	(44,920)	(48,898)	(47,089)	(44,598)	(43,585)	(45,266)	(60,528)
Interest Expense on Certificates	(147,614)	(164,788)	(179,278)	(188,480)	(191,048)	(197,622)	(204,930)	(212,075)
Amortization of Underwriting Fees	(1,300)	(1,474)	(1,680)	(1,850)	(1,915)	(1,970)	(2,055)	(2,152)
Net Investment Income (Loss)	26,398	29,889	32,476	39,004	45,224	50,881	54,550	44,560
Portfolio Management Fees	5,970	4,149	1,535	0	0	0	0	0
Licensing Fees	100	100	100	150	150	150	150	150
Examination Fees	1,365	1,415	1,465	1,540	1,615	1,690	1,765	1,840
Examination Costs	(1,365)	(1,415)	(1,465)	(1,540)	(1,615)	(1,690)	(1,765)	(1,840)
General & Administrative Expense Allocation	(4,045)	(4,248)	(4,460)	(4,683)	(4,917)	(5,163)	(5,421)	(5,692)
Depreciation Allocation	(264)	(286)	(308)	(220)	(220)	(220)	(220)	(220)
Income (Loss) before Taxes	26,159	29,603	29,344	34,251	40,237	45,648	49,050	38,798
Income Tax Allocation	(4,456)	(10,361)	(10,270)	(11,968)	(14,083)	(15,977)	(17,170)	(13,579)
Net Income (Loss)	$23,703	$19,242	$19,073	$22,283	$26,154	$29,671	$31,888	$25,218
SUMMARIZED CASH FLOW STATEMENTS								
Net Income (Loss)	$23,703	$19,242	$19,073	$22,283	$26,154	$29,671	$31,888	$25,219
Increase (Decrease) in Deferred User Fees	1,607	1,176	2,736	1,659	1,392	1,908	2,380	3,226
Decrease (Increase) in Deferred Underwriting Fees	(402)	(295)	(684)	(465)	(348)	(477)	(580)	(607)
Provision for Losses on Debentures	41,886	44,920	48,898	47,089	44,598	43,585	45,266	60,528
Depreciation Allocation	264	286	306	220	220	220	220	220
Cash from Operations	66,857	65,332	70,329	70,968	72,016	74,887	79,145	88,385
Investments in Debentures	(272,279)	(282,915)	(378,289)	(370,383)	(362,120)	(391,451)	(423,222)	(473,375)
Debenture Repayments	12,752	10,421	175,481	267,272	220,200	235,751	255,370	305,825
Capital Expenditure Allocation	(220)	(220)	(220)	(220)	(220)	(220)	(220)	(220)
Cash from Investing	(259,747)	(272,713)	(203,027)	(103,311)	(142,140)	(155,920)	(168,072)	(167,870)
Certificate Issuance	272,279	282,915	378,289	370,363	362,120	391,451	423,222	473,375
SBIC Shareholders' Equity Investment	3,300	3,180	3,060	3,150	3,450	3,750	4,050	4,350
Scheduled Repayment of Certificates	0	0	0	0	0	0	0	0
Dividends	(5,356)	(5,007)	(6,157)	(6,487)	(6,396)	(6,185)	(5,634)	(4,379)
Cash from Financing before Prepayments	270,223	281,088	375,192	367,026	359,174	389,016	421,638	473,346
Prepayments of Certificates	(77,334)	(73,707)	(242,494)	(334,682)	(289,050)	(307,983)	(332,710)	(393,760)
Cash from Financing after Prepayments	192,890	207,381	132,698	32,345	70,123	81,033	88,927	79,585
Increase (Decrease) in Cash	$0	$0	$0	$0	$0	$0	$0	$0

Schedule V

Chairman BOND. Thank you, very much, Mr. Dunbar.

To all of you, I would like to have your comments about a segment that the National Public Radio aired earlier this week on the SBIC program. I understand that the story stated that there is so little difference between the new generation of SBICs recently licensed by SBA and private investment firms, that the deals being done by SBICs are very similar to the ones in the private sector without a Government guarantee. From this they conclude that the program may not be needed.

Let us start with Ms. Pulley.

Ms. PULLEY. I am glad you asked that question.

I think all three of the panelists have indicated that what is happening in the private sector now is that the venture capital firms are consolidating. They are becoming larger. As they become larger, their emphasis changes. I think that is certainly one of the things we have been seeing.

As a result of the changes in the 1992 Act, certainly the venture capital firms that SBA itself is licensing are becoming larger, but that is because we are trying to get stronger companies that are better capitalized. But still, I think there is an issue of economies of scale in the industry. There is a segment that the private sector should take care of and does take care of. But there is also clearly a need in the private sector for smaller firms that need the benefit of Government assistance in order to finance the smaller sized businesses.

I would turn to the private people.

Mr. DUNBAR. I agree with Ms. Pulley, that the most significant change has been actually a divergence where the larger venture capital firms are becoming larger and it is more and more difficult for them to do smaller deals. The actual average size of an SBIC financing over the last 10 years was under $500,000, whereas the average size of non-SBIC venture capital financings is closer to $5 million, and that spread is actually increasing over time as the consolidation that Ms. Pulley alluded to continues.

In addition, I think Ms. Cloherty made the point earlier of geography. Most of the venture capital firms are headquartered in New York, Boston, or California. As a result, they tend to invest close to home. SBICs tend to be much more geographically diverse and, in fact, over 50 percent of the SBIC-backed companies are located in areas other than Boston, New York, and Silicon Valley.

And finally, SBICs have a much better track record over the years of investing in non-technology based companies. Over three-fourths of the small businesses funded by SBICs have been non-technology based companies whereas the non-SBIC venture capital industry is much more focused on technology based companies.

Chairman BOND. Ms. Cloherty?

Ms. CLOHERTY. I disagree with the major premise built into the view. I did not hear the radio program, but I am not of the view that everything that Government backs or does has to be a basket case.

I do think there will be joint deals between private venture companies and SBICs and, in fact angels or wealthy individuals. I think that that is quite reasonable. But I think the dominant pattern of investing will be in the smaller deals. And I am conclusory

on the previous panel. Two of the companies on that panel would not have gotten money from us, period. They simply do not have the kind of growth or are not in the industries. SBICs, however, will finance them.

The second matter is that the program, as I tried to point out, has other purposes that perhaps are even more valuable than the provision of capital itself. I think that the creation of the cadre of seasoned risk capital managers is No. 1, it is a treasure of the country. I think the person on NPR may not be familiar with that concept.

The second thing, the issue of having a vehicle where people can put their money to work is important without having to be very rich. Dr. Smith, for example, can put $200,000 into an SBIC to have someone take care of it professionally. I think that is terribly important, so there is a role.

Chairman BOND. Ms. Pulley, on behalf of my colleagues from Maine and some of the other States that you mentioned, we were delighted to hear the new SBICs being formed in places other than Boston, New York, and California. Are there any other things that we can do? I might ask the private sector folks to get more of the kinds of small business financing for Arkansas and Montana and Minnesota and Georgia and the rest of the country.

Is there any reason, other than geography and inertia, that they are not getting the venture capital access for the small businesses to middle America or the heartland, as we might call it?

Ms. CLOHERTY. We have offices in Pennsylvania and California and we have investments across the country. We look for them. There tend to be—the industries in which a high rate of secular growth is occurring, as in the computer business, have tended to be concentrated in particular areas. And those offer the growth opportunities that we need.

One colleague in my business points out, though, that in the era of automotive growth, Cleveland was Silicon Valley. But the growth that we look for is not occurring in many States of the Union, but there always are respectable companies that warrant financing but may not throw off internal rates of return of 40 percent a year because their markets are local or regional.

Mr. DUNBAR. I think the biggest issue is fund size. Because of the SBIC program, it is possible to raise and operate a fund that can be viable with $5 million or $10 million because you have the ability to leverage that two to one at the SBA and potentially with bank borrowings as well. Whereas, it is impossible to have a venture capital fund that is viable that is only $5 million or $10 million in size.

And yet, if you are located in an area such as West Virginia, where SBA licensed two new SBICs last year, it is impossible to raise a fund of $40 million or $50 million because there are not enough opportunities close to home. So it is possible to have a fund that can focus on close to home deals, and yet still operate economically because you have the ability to leverage the fund with SBA dollars.

Chairman BOND. I am going to close this very shortly because I promised everyone we would be out of here at 11:30, but one thing that Mr. Thompson suggested, I do not know if you have any com-

ments on it, he suggested that the SSBICs be rolled into the SBICs with the notion that there should not be two distinct kinds of entities, that a regular SBIC ought to be able to make the kinds of financing available that the SSBICs do.

What would be your reaction to that, Ms. Pulley?

Ms. PULLEY. Mr. Chairman, I mentioned that the SSBIC program has an independent Investment Advisory Council that is doing work similar to what Ms. Cloherty's group has done. We expect to have their report within the month, and I think that is one of the issues they are considering. Once we get that report, we will be happy to discuss it with you, but it is certainly an option that that body is reviewing and it deserves a great deal of consideration.

Chairman BOND. Ms. Cloherty, you mentioned you did not make an extensive investigation of the liquidation function, but you do know it needs to be done faster. Is contracting out perhaps one of the ways to get the liquidation done better? Have you looked at it to that extent to know?

Ms. CLOHERTY. Again, I hasten to add because I do not know the nature of the entire portfolio, so it is difficult to say. I would certainly think so. I mean, I would think that you might even—in order to expedite matters—it may be worth taking the risk that whoever does it might even make some money on it.

Chairman BOND. A good old-fashioned idea.

Ms. CLOHERTY. It is a good old-fashioned idea. It gets people out of bed in the morning and focused on the subject at hand. So again, depending on the nature of the assets (real estate is quite different from the operating companies), I would think that some contracting out—with a split of the proceeds—would be quite a good way to do it.

Chairman BOND. Ms. Pulley?

Ms. PULLEY. Mr. Chairman, currently 94 percent of the liquidation portfolio is contracted out, either through receiver's agents, through self-liquidation agreements with the SBICs, or through the sale of assets. I think, however, that within that, the issue that SBA has to address from the management standpoint is what do we do before it gets to liquidation? I think Ms. Cloherty's point was that speed is the issue here.

I think, in the process of reviewing this program over the past 2 years, we have tried to address a number of issues. Certainly the legislation enabled us to do a lot of things with the participating securities. There is still a long ways for us to go with correcting the program. I think the Council's report will be invaluable.

The second working group out of the Council will be one that looks at the administrative functions. So while we are contracting out a portion of the liquidations right now, there may be other functions we can contract out prior to that point that might facilitate the process. But it is an issue that we are trying to address.

Chairman BOND. I cannot dismiss this panel without asking an open-ended question to Mr. Stillman, who is a real expert in this area. I know there may be some things of which you cannot speak, realizing that the Agency has to get clearance, but based on our discussions of things like going to a GSE, from your personal experience do you have any views or considerations that we should be apprised of as we go down this road?

Mr. STILLMAN. Obviously, we welcome any opportunity to increase the size of the program and reduce its cost to the taxpayers. In that sense, we admire the work that NASBIC has done in this proposal and the work that Pat has done on the Reinvention Council.

The concern we have with the GSE proposal is endemic to the concept of a GSE, which is in the areas of the risk to the Government, the cost to the Government, and the proper scoring to the Government.

In the GSE proposal, as with Fannie Mae, investors are buying securities at rates that are just a modest premium over Federal Treasury rates, which suggests that those investors are expecting that the Government is ultimately going to stand behind the paper. To the extent that they are standing behind the paper, there is a risk to the Government, and it is our understanding that under credit reform, in general, the thrust has been to have a recognition of that risk in the budget.

As to the cost, since the proposed GSE would charge a fee for supervising the existing portfolio, there would be a requirement for, I believe, $34 million of fees to be paid by the Government in the first year for that supervision. I think these are issues that need to be considered in considering the two proposals.

Certainly either of the proposals, to the extent that they shift cost away from the taxpayer and to the SBIC owners themselves strikes us to be a very worthwhile way of accomplishing these two objectives and leading toward ultimate privatization.

Chairman BOND. Thank you very much, and thanks to all of you again. As I said with the last panel, we are going to have continuing questions. There are a number of studies outstanding. I am sure some of my colleagues may wish to submit questions for the record, and we may even give you a telephone call to get your official or unofficial views as these issues develop.

Again, this is a very important issue to this Committee and unfortunately we had a day in which there were many other committees very actively engaged in their work, as well. We do appreciate the panel's time and effort to give us the good guidance with respect to the SBIC and SSBIC program.

With that, I will thank you. The Committee stands adjourned.

[Whereupon, at 11:37 a.m., the Committee was adjourned.]

COMMENTS FOR THE RECORD

Comments of
Bruce Gamble
President
National Association of Investment Companies

Presented to the
Committee on Small Business
U.S. Senate

Hearing on the
Small Business Investment Company Program

Mr. Chairman and Members of the Committee, I am Bruce Gamble, President of the National Association of Investment Companies (NAIC), the trade association for venture capital firms that dedicate their financial resources to investment in small and minority-owned businesses. Members of NAIC include privately-owned Specialized Small Business Investment Companies ("SSBICs") licensed and regulated by the U.S. Small Business Administration ("SBA"), privately-owned venture capital firms which manage investment partnerships ("private equity funds") and quasi-private investment companies chartered by state and local governments for the purpose of minority-focused investing. On behalf of NAIC, I am pleased to have the opportunity to provide the following comments regarding the SSBIC program.

SBICs are private, profit-oriented investment companies that make loans or equity investments in eligible small businesses pursuant to the requirements of the Small Business Investment Act of 1958, as amended ("the Act") and regulations promulgated thereunder. Today, there are two types of licensees: 1) "regular" SBICs, licensed under Section 301(c) of the Act, and 2) "Specialized" SBICs, licensed under Section 301(d) of the Act, commonly referred to as SSBICs.

Generally, the same rules and regulations apply to both types of licenses (with certain exceptions). Section 301(d) of the Act, however, requires that companies licensed under this section (i.e., SSBICs) invest only in businesses owned and controlled by persons whose ability to compete in the free enterprise system is hampered by social or economic disadvantages. Certain ethnic minorities are presumed by law to be socially disadvantaged and as such, are presumed eligible for financing by 301(d) Licensees.

Since the fall of 1994, NAIC has been engaged in serious discussions with SBA regarding ways in which the Section 301(d) program can be restructured to: improve program management, promote investment policies that allow Licensees to respond to market realities, and create an environment for increased and stable leverage for Licensees. These discussions have taken place informally with SBA policy makers and in a more structured forum under the official title, the "SSBIC Advisory Council". Since these discussions began, several events have occurred which have resulted in particularly challenging issues for Section 301(d) Licensees. These challenges, some of which are outlined herein, have lead the Association to formulate a set of recommendations which it believes will result in a more viable investment program which promotes innovative entrepreneurship as envisioned by the early advocates of the SBIC program.

Overview: The Challenges

The recent Supreme Court decision in *Adarand Constructors v. Pena* is expected to have broad negative implications for many minority business development programs administered by the Federal government. In the Adarand case, the Supreme Court ruled that lower courts must now review any race-based statute to ensure that it serves a "compelling government interest", and that it is "narrowly tailored" to further that interest. Although the SSBIC program is not customarily associated with traditional affirmative action legislation, Congress and the Small

Business Administration have engaged in an exhaustive review of all programs that contain ethnic classifications or race-based preferences to determine if those programs meet this new more, rigorous standard. In fact, legislation has been introduced in both Houses that reportedly goes beyond the *Adarand* ruling to end Federal race and gender based programs.

On another front, SBA has sought to provide, through several revisions to Policy and Procedure Release (PPR) #2017, guidance to Section 301(d) Licensees in determining if individuals are indeed eligible (i.e., "socially or economically disadvantaged") for financing. Attempts have also been made in the past to link the social and economic disadvantage categories. More recently, SBA has sought to modify PPR #2017 to include a means test (e.g., personal net worth; company net worth) to help 301(d) Licensees determine whether an individual meets the economic disadvantage test for financing. To quote from language currently incorporated in a recent draft of PPR #2017, "[i]ndividuals who have accumulated substantial wealth, who have unlimited growth potential or who have not experienced or have overcome impediments to obtaining access to financing, markets and resources do not meet the criteria described herein". Any eligibility test based on personal or business financial condition runs counter to a successful investment program and precludes Licensees from properly focusing on the critical elements of a successful investment. In light of *Adarand*, funding cuts by Congress, and other restrictive SBA policies, it appears that rather than improving the conditions under which SSBICs can facilitate a greater flow of private investment capital toward innovative entrepreneurial ventures, efforts are underway to frustrate the Programs' intent. Funding constraints cause existing Licensees to discontinue new investing while at the same time eliminate incentives (i.e. SBA guaranteed leverage) for potential entrants into the 301(d) program. Restrictive policies such as those mentioned in PPR #2017 above would further narrow the entrepreneurial class to marginally viable and nonviable businesses which may be eligible for financing by existing 301(d) Licensees.

Funding

In recognition of the extraordinary difficulties encountered by socially or economically disadvantaged entrepreneurs in obtaining debt or equity capital, Congress provided 301(d) Licensees with leverage options in addition to those available to SBICs (i.e., 4% preferred stock and partially subsidized debentures). The purpose is to provide economic tools that SSBICs can use to attract and pool private capital to meet the needs of this underserved market. Empowered by Congress to compute "subsidy" rates (net present value of investment) for all securities sold by Licensees to the SBA, the Office of Management and Budget ("OMB"), has deemed (based on SBA assumptions) that SSBIC leverage carries a substantially higher subsidy rate than SBIC leverage. Assumptions used in computing the subsidy rate for 301(d) issued securities is reportedly based on historic and prospective loss ratios and the premium (above market value) offered for each security. Under current assumptions, the subsidy rate computed for 301(d) debentures is 29%, and 43% for 4% preferred stock. Conversely, the subsidy rate computed for participating securities is 8.9% (with no basis for an actual historical loss ratio), and 14% for unsubsidized debentures. NAIC does not accept OMB's evaluation as accurate. If the goal of reform however, is to reduce overall SBIC Program costs to taxpayer, then it follows that the subsidy rates must decline. It is vitally important that we not lose sight of the original purpose for providing SSBICs with alternative forms of leverage.

Given the disparity between the SBIC and SSBIC leverage subsidies, and the questionable nature of evidence to support the disparity, it is imperative that an independent third-party re-evaluate the assumptions used in the computation model for the subsidy rate for SSBIC leverage. This re-evaluation of the loss rate assumptions to determine realistic levels should result in a significant reduction in the subsidy rate for SSBIC securities. In testimony before this Committee by Cassandra M. Pulley, Deputy Administrator, U.S. Small Business Administration, Ms Pulley noted that most of the leverage funds available in the SBIC program are secured from open market sale of securities guaranteed by the SBA. Thus, the taxpayer cost of the subsidy for the program is only that fraction of the amount of leverage which is needed to fund anticipated future

losses. A reduction in the loss rate assumptions could assist in the preservation and augmentation of current level funding for SSBIC leverage (i.e. 4% preferred stock and subsidized debentures). Realistic loss rate assumptions of current 301(d) securities would also serve to enhance valuation of SSBIC asset backed financial instruments for securitization purposes as a compliment or alternative to government leverage.

Public/Private Partnership

The SBIC program was designed as a public/private partnership, where SBA becomes a partner with private capital sources (i.e. SBICs/SSBICs) to provide a full range of financing needs to small business enterprises. The key to stimulate investment in small entrepreneurial concerns is the cost and availability of capital. The key to a successful public/private partnership is stable, predictable funding which can grow to meet the needs of small business enterprises and regulatory policies that are consistent with sound investment practices. If government funding continues to be unstable and trends suggest significant reductions or total elimination of 301(d) leverage (see Committee on Appropriations, House Report 104-196), then it would be prudent for government policy to facilitate the flow of private capital from other sources including the capital markets.

As noted in testimony before this Committee by Patricia Cloherty, Chairman, SBIC Reinvention Council, the Council reviewed the public policy purpose of the program and its current status, and sought an approach to the program that would cause it to work better, at reduced cost to the government, in a way that had greater likelihood of being implemented near-term. That report, dated June 23, 1995, has been submitted to Committee members. NAIC's General Counsel, William A. Kirk, Jr., who served on the Council, submitted very cogent additional and supplementary views, some of which are incorporated herein.

With respect to Council recommendations in support of contracting out SBIC Program administration to the private sector, NAIC would concur with the Council that management of the SBIC Program should be performed by those who have expertise in the area of venture capital investing. It is our view that this is another important step in making the SBIC Program a true investment program. While the Council report noted that policy changes enacted by Congress in 1992 as part of the Small Business Equity Enhancement Act ("the 1992 Act") strengthened the SBIC Program in many important ways, many Program regulations actually contribute to a tendency of the SBA toward "micro-management" of Licensees.

Regulations that restrict or control a Licensee's ability to make sound business decisions diminishes the Licensee's capacity to respond to a changing marketplace and assist small businesses, reduces the potential returns to the Government and other investors, and may ultimately threaten the Licensee's viability. As part of the reinvention process therefore, SBA should appoint a working group to review the Program regulations in terms of their relevance to an investment program and their effectiveness in facilitating the flow of capital to small businesses in concert and in partnership with the private sector.

Program Restructure

Given current trend factors, fundamental change in the construct of the SSBIC program is warranted. One major recommendation contained in the accompanying report submitted by NAIC entitled "Proposals for Restructuring the Small Business Investment Company Program" (Exhibit 1) is the consolidation of the 301(c) and 301(d) programs. Accordingly, NAIC recommends that current language contained in Section 301(d) of the Small Business Investment Act of 1958, as amended ("the Act"), be struck, eliminating references to "social" or "economic" disadvantage designations in the 301(d) program. New statutory language should be inserted to emphasize and provide incentives for investment in "smaller entrepreneurial concerns" (defined as small business concerns with net worth of $1 million or less and after-tax net income of $500,000 or less).

Under this approach, targeted incentives categorized in the report could be directed to Licensees identified as small business investment companies who maintain a percentage (i e., 70% or greater) of their first-time portfolio investments in smaller entrepreneurial concerns. This designation removes race and ethnicity from criteria currently used to distinguish, and arguably stigmatize 301(d) Licensees.

Certain transition matters would have to be addressed. Existing SSBICs would need to be grandfathered and assured that they could have access to leverage. One suggestion would be to restructure the SBIC Program's leverage allocation by preserving by statute a significant portion of future leverage (e.g., one-third) to Licensees whose portfolios reflect a preponderance (i.e., 70%) of first time financings with smaller entrepreneurial concerns. This reserved leverage pool would be available to any Licensee whose investment portfolio meets this standard.

Conclusion

In making recommendations contained in the accompanying report, NAIC continues to believe that there is a compelling government interest in promoting and providing incentives to facilitate the flow of private investment capital toward small business enterprises owned by socially or economically disadvantaged entrepreneurs, a segment of the economy which remains underserved and largely ignored by traditional financial intermediaries. Economic and political realities suggest however, that it will be extremely difficult to preserve or enhance incentives for this targeted investing (i.e., Congressional appropriations for 301(d) leverage funding) within the current SSBIC program structure in light of: (1) the Supreme Court decision in *Adarand v. Pena*, (2) Congressional review of ethnic and race-based classifications, and (3) Congressional efforts to reduce the Federal budget with major reductions in SBA's business loans program account.

Recommendations contained in the report are designed first and foremost to make the SBIC program consistent with good, sound business practices. These recommendations also seek to eliminate distinctions between SBICs and SSBICs which have resulted in a steady erosion of SSBIC benefits (i.e., Debentures and 4% Preferred Stock leverage), with concurrent and increasing impediments (i.e., unnecessary and unwarranted regulatory burden). Provisions of the Act and program rules should be judged by their effect on advancing the fundamental mission to provide long-term debt and equity capital to underserved smaller entrepreneurial businesses.

NAIC maintains, as others have argued, that "innovative entrepreneurship is America's best chance for realizing a national competitive advantage in the twenty-first century." (W. Bygrave, J.A. Timmons, Venture Capital at the Crossroads (1992)). Entrepreneurial innovation built our semiconductor, computer, and biotechnology industries. Because long-term debt and equity capital is the most vital element of the entrepreneurship equation, we as a nation must do more than just accept or condone it, we must actively foster it. Government policies are undoubtedly the most powerful promoter or inhibitor of venture-capital backed entrepreneurship. As such, we must ensure that policy initiatives foster entrepreneurship and innovation well into the next century and not allow the SBIC Program to languish due to benign neglect.

NAIC believes that the SBIC Program can truly make a significant contribution with respect to small and minority business development, but only if: (1) the SBIC Program is restructured and managed as a bona fide investment program which permits Licensees to exercise sound business judgment; and (2) the Program contains market-responsive tools that will assist and not discourage Licensees' ability to attract private capital.

Thank you for allowing me the opportunity to present NAIC's views on the SBIC/SSBIC Program.

National Association of Investment Companies
Proposals for Restructuring the Small Business Investment Company Program

This report represents recommendations of the National Association of Investment Companies ("NAIC") concerning restructuring of the Small Business Investment Company ("SBIC") Program.

Summary of Recommendations

- The existing two types of Small Business Investment Company licenses, "regular" SBICs, and "Specialized" SBICs, should be merged into one license in a consolidated program. Licensees would be evaluated and program benefits made available based upon the size of the small business concerns financed and not by whether the concern is owned by a person who is "socially or economically disadvantaged".

- The SSBIC program administration, including licensing and audits, should be "privatized". In the short term, program administration should be contracted out to the private sector. For the longer term, NAIC endorses establishment of a government sponsored enterprise (GSE), to ensure greater stability and availability of leverage.

- Program policies should be reformed to permit Licensees to exercise sound business judgment.

- The 7(a) Loan Guarantee Program should be expanded to permit Licensees to qualify as lenders.

- Targeted tax and securities law policy changes should be enacted to enable Licensees to attract private capital.

Background

The SBIC Program was created by Congress to address the shortage of long-term debt and equity capital available to small businesses. To this end, the Small Business Administration ("SBA") is charged with supplementing or "leveraging" the private capital of Program Licensees.

SBICs are private, profit-oriented investment companies that make loans or equity investments in eligible small businesses pursuant to the requirements of the Small Business Investment Act of 1958, as amended ("the Act") and regulations promulgated thereunder. Today, there are two types of licensees: 1) "regular" SBICs, licensed under Section 301(c) of the Act, and 2) "Specialized" SBICs, licensed under Section 301(d) of the Act and commonly referred to as SSBICs.

Generally, the same rules and regulations apply to both types of licenses (with certain exceptions). Section 301(d) of the Act, however, requires that companies licensed under this section (i.e., SSBICs) make investments oriented solely towards the needs of entrepreneurs whose opportunities to own and operate businesses have been limited by social or economic disadvantages.

Certain ethnic minorities are presumed by law to be socially disadvantaged and as such, are presumed eligible for financing by 301(d) Licensees.

Objectives and Recommendations

This report is divided into nine (9) sections which discuss and make recommendations regarding short and long term improvements in SBIC Program operations and investment policies, alternatives for attracting private capital into existing and prospective Licensees, and options to reduce federal SBIC budget expenditures. The reduction of federal budget outlays is perhaps the primary factor driving various proposals by SBA and under consideration in the Congress to restructure the SBIC Program. While this is an important and critical objective, NAIC believes that the SBIC Program requires fundamental management and policy changes if the Program is to be an effective "public/private partnership".

In submitting the following recommendations, NAIC recognizes that there will be a transitional phase for implementation of the changes both legislative and regulatory in nature. Given that one major recommendation is merger of the separate 301(c) and 301(d) licenses into a consolidated program, conforming amendments may be necessary to grandfather certain benefits (e.g., tax incentives, definition of private capital), currently limited to 301(d) Licensees.

I. SBIC Program Consolidation

Under present law, SBICs and SSBICs are distinguished not by the types of businesses in which they invest, but by race or economic characteristics of the entrepreneur. While 301(c) Licensees may invest in businesses owned by persons who are deemed "socially" or "economically" disadvantaged, 301(d) Licensees may invest only in firms owned by such persons. Because of this distinction, and the perception of associated risk, 301(d) Licensees have been hampered in their ability to attract private capital. This distinction has also unfortunately resulted at various times in arbitrary SBA interpretation and application of program guidelines.

In promulgating regulations pursuant to the 1992 amendments to the SBIC Act, SBA revised one of the two size standards that establish eligibility criteria for small business concerns applying for assistance from Small Business Investment Companies. That rule increased ceilings on the SBIC Standard, from $6 million in net worth and $2 million after-tax net income, to $18 million in net worth and $6 million after-tax net income. NAIC believes that revising the size standard has certain benefits for larger SBIC Licensees who wish to finance larger, later-stage transactions. Increased emphasis on larger transactions, however, by definition results in less Federal and private resources directed toward smaller and earlier-stage investment opportunities as observed in the private equity marketplace.

Although "regular" SBICs and "specialized" SBICs are distinguished by statute and regulation by their investment focus, there is one other distinction between the two which is manifested in the size of the small business enterprise financed.

SSBICs tend to direct first-time investments in smaller entrepreneurial concerns (herein defined as companies with net worth of $1 million or less and after-tax net income of $500,000 or less), or earlier-stage companies that still suffer from a shortage of long-term debt and equity capital. NAIC believes that public policy should recognize and encourage Licensees that, by virtue of their investment strategy, choose to invest in smaller entrepreneurial concerns as defined herein. That encouragement should at a minimum be reflected in a policy that causes a threshold leverage allocation to be reserved for any Licensee who predominately finances smaller entrepreneurial concerns. In making this determination, the Licensees' portfolio should be comprised of first-time investments (i.e., 70%) in smaller entrepreneurial concerns ($1 million net worth/$500,000 after-tax net income).

In other respects, SBICs and SSBICs maintain many more common characteristics than those that distinguish the two licenses. Both types of Licensees are: private, profit motivated investment companies; provide long-term debt and equity capital to small businesses; invest in small business concerns in various stages of a firms development; and both Licensees are required to perform due diligence with a focus on strong management.

Thus in the most critical areas of operation, there is really one type of SBA regulated company.

Recommendation:

- The current distinction between SBICs and SSBICs should be eliminated. There should be one type of license in a consolidated program. Separate appropriations for leverage would be eliminated as well as other statutory and regulatory distinctions between 301(c) and 301(d) Licensees.

- Under a consolidated program, a threshold leverage allocation would be reserved for any Licensee who predominately finances smaller entrepreneurial concerns (defined as companies with net worth of $1 million or less, and after-tax net income of $500,000 or less) concerns. Licensees' investment profiles would be determined by the degree to which their portfolios are comprised of first-time investments in smaller entrepreneurial concerns (e.g., 70%, measured on a rolling three year average).

- Licensees would be evaluated and program benefits would be made available based on the size of small businesses being financed (i.e. first-time investment) -- and not by whether the concern is owned by a person who is "socially" or "economically" disadvantaged.

- All references to "social" or "economic" disadvantage should be deleted from the Small Business Investment Act.

- As part of a transition to a consolidated program:

  (1) existing SSBICs should be "grandfathered" with respect to their company's operations and minimum capital requirements for all purposes including changes in ownership or control of Licensee,

(2) the ability of grandfathered SSBICs to obtain leverage during the transition period would be preserved.

- Under a consolidated program, the minimum capital requirement for new Licensees would be consistent with current law for 301(c) Licensees ($2.5 million). The minimum regulatory capital requirement set forth for eligibility to issue Participating Securities would be $5 million (13 CFR 107.241).

II. Privatization

As Congress continues to shrink the Federal budget, it has become clear that a number of government programs, including the SBIC program, will continue to see diminishing federal funding in fiscal year 1996 and beyond. NAIC believes that for the long term, to ensure stability of program leverage, creation of a government-sponsored enterprise (GSE) should be explored. This privatization model, which would provide leverage through the purchase of SBIC securities, by selling its own securities in the capital markets, could be structured (with certain modifications) in similar fashion to the privatization proposal set forth by the National Association of Small Business Investment Companies (NASBIC).

A number of GSEs have been created by Congress to facilitate capital flows to various sectors of the economy. Examples of GSEs currently in operation include the Federal National Mortgage Association (Fannie Mae) and the Student Loan Marketing Association (Sallie Mae). Although GSEs receive Federal charters from Congress which provide an operational framework, and a grant of corporate authority, GSEs are privately owned and operated. As such, it is imperative that governance issues be addressed to ensure that under a GSE structure, smaller entrepreneurial focused Licensees have either Board representation or cumulative voting rights.

Recommendation:

As a longer-term strategy, a new off-budget government-sponsored enterprise (GSE), should be established with certain key features including:

- Private ownership of GSE with Licensees owning the voting common stock.
- Control by a Board of Directors.
- Mandatory Board representation by former SSBICs, and smaller entrepreneurial focused Licensees.
- Cumulative voting rights.
- Priority funding or dedicated share of leverage available to former SSBICs and Licensees who finance smaller entrepreneurial concerns (as defined herein).

III. SBIC Program Management

The SBIC Program is an investment program which is fundamentally different in character from other SBA-financed

programs which are transaction specific in orientation and typically short term in duration. By contrast, in the SBIC Program the Federal Government, through the SBA, "invests" on a long-term basis with a Licensee through the provision of leverage. Specific portfolio investment decisions rest exclusively with Licensees.

Because of its special characteristics, an effective SBIC Program requires staff who are specialists in investments and who have knowledge of related financial matters. The staff should also possess expertise in areas such as partnership law, as opposed to only legislative and regulatory law. Moreover, the staff should be capable of performing due diligence with respect to new license applications.

The Act does not contain explicit due process protection which should be guaranteed to Licensees. Moreover, SBIC Program regulations are often vague. As a result SBA officials, under the banner of administrative discretion, have on occasion inappropriately intervened in the investment decisions and operations of Licensees.

The process of changing the SBIC program began in 1992 with enactment of the Small Business Equity Enhancement Act ("the 1992 Act") which created a second form of leverage, the "participating security", designed for larger Licensees and those who are primarily equity investors. The 1992 Act modified the definition of "private capital" to include capital invested by pension funds and under certain circumstances capital invested by state or local governments. The 1992 Act also raised the minimum capitalization requirements for new Licensees.

By and large, the SBIC Program has been strengthened as a result of the 1992 Act; however, additional reform is needed. Moreover, some of the regulations promulgated pursuant to the 1992 Act, while well intentioned, continue a tendency of the SBA toward "micro-management" of SSBICs, while providing incentives (i.e., participating securities) for larger SBICs.

Recommendation:

- SBIC Program administration should be managed by investment professionals. Program administration (including the evaluation of potential new Licensees) should be contracted out to private sector concerns with the requisite investment expertise.

- The Small Business Investment Act should be amended to provide explicit due process protection for Licensees to minimize the possibility of arbitrary actions by SBIC Program management.

IV. SBIC Program Investment Policies

To more effectively meet the public policy objectives under the Act, the SBIC Program should emulate and incorporate many of the fundraising and investment policies utilized by the venture capital industry. As noted previously, the 1992 Act took several important steps in this regard.

For example, the 1992 Act partially conformed the Program to a common practice within the venture industry of acknowledging binding commitments from institutional investors so that capital drawdowns can be coincident with actual portfolio investments. However, many existing SBIC program regulations restrict and curtail a Licensee's ability to make good business judgments. Unnecessary constraints reduce a Licensee's viability thereby reducing the potential financial and social returns to the government.

The 1992 Act also permits an SSBIC to include in private capital for any purpose, funds indirectly obtained from State or local governments. This provision was designed to channel new capital into SSBICs while retaining their character as privately owned and operated investment companies. The SBA, however, has interpreted (through implementing regulations) this provision in a manner inconsistent with its intended purpose. These regulations should be corrected in conformance with Congressional intent to permit an unrestricted percentage of an SSBIC's private capital to include indirect state and local government funds.

Given that the objective of the SBIC program is to facilitate the flow of capital to small business concerns, such enterprises controlled by private equity funds should not be disqualified based upon the size status of the private equity fund. Current regulations require that when determining eligibility of an applicant (small business) concern for financial assistance under the SBIC Program (13 CFR § 121.802(a)(3)), the Licensee must consider the financial size of the applicant concern and all of its affiliates. This consideration incorporates the size of the applicant concern, the private equity fund that controls the applicant, and other enterprises controlled by the private equity fund. This requirement results in numerous small businesses controlled by private equity funds being unjustly deemed ineligible for financing by an SBIC Licensee."

Recommendation:

- Private equity funds should be excluded from size status consideration of affiliates in determining eligibility of an applicant concern for investment by an SBIC Licensee.

- Issuance of an SBIC program license should model the approach of investment partnership agreements. Accordingly, (1) the license issuance should represent an agreement with the Licensee that after private capital is committed, the licensing terms will remain constant for a period of not less than ten (10) years unless otherwise agreed by mutual consent, and (2) capital commitments should be fully recognized for purposes of meeting minimum capital requirements.

- During the transition to consolidation, there should be full recognition of funds indirectly obtained from state or local governments as private capital for any purpose for SSBICs (e.g., state or local grants to non-profit organizations that result in investments in SSBICs).

- Capital commitments should be treated as private capital for any purpose including accessing leverage.

- Leverage should be available for drawdown simultaneously (on a "lock step" or pro rata basis) when private capital commitments are funded.

- Eliminate restrictions on capital distributions contained in 13 CFR Section 107.802, for non-leveraged Licensees.

- During the consolidation transition period, strike current language in Section I. of Policy and Procedure Release #2017 (i.e. Statement of Policy), and insert in lieu thereof the following new language:

I. Statement of Policy

"The aim of Section 301(d) of the Act is to encourage the development of small business concerns in which ownership, control and management are vested in persons who are hampered by social or economic disadvantage ("Eligible Person(s)"). At the same time, in many businesses the capital requirements are so large that it is not possible for "disadvantaged" entrepreneurs to retain more than 50% of the economic ownership while giving outside investors a sufficient economic ownership position to provide them with a reasonable rate of return. Licensees should adhere to the following guidelines:

A. Control: Eligible Persons must have a majority voting interest on the board of directors or other governing body of the concern being financed. Following an investment by an SSBIC, Eligible Persons must own more than 50% of the voting interest of a corporation or general partnership. If the SSBIC invests in a limited partnership, Eligible Persons must be the general partners or must control (as defined herein) any corporate general partner.

In any of these investments, as part of a program designed to protect its investment at a time of adverse performance, the investment group, including the SSBIC, may insist on the exercise of voting control until such adverse performance has been corrected. No ineligible person or entity may otherwise control the recipient of SSBIC financing, either through ownership, contract, or other means.

B. Ownership: Following investments by an SSBIC, the Eligible Persons may not own less than a 25% economic interest in the company, including at least a 20% direct ownership interest, with an additional interest available through exercise of management stock options, ESOP participation or similar means. Economic interest is the right to proportionate distributions after satisfaction of all secured and unsecured debts. If Eligible Persons hold less than 50% of the economic interests, a majority of the economic interest must be held by SSBICs or other investors not in the same or similar line of business and who are not associates, affiliates or close relatives as defined in 13 CFR 107."

V. Debt Oriented Transactions

Licensees who provide long-term debt investments are often the only financial resource available to many underserved small business enterprises. Many of these same enterprises also need short-term debt which may not be available through traditional financial intermediaries. As such, SBIC program policies should permit Licensees to be responsive to both long term and short term debt financing needs of smaller entrepreneurial concerns. To further their continued viability, Licensees who make such investments should be able to realize a reasonable return on investment.

By enacting the SBIC Act, Congressional intent is clearly expressed in Section 102, the "Statement of Policy", which declares that as a matter of policy, the SBIC Program "... shall be carried out in a manner as to insure the maximum participation of private financing sources" (15 U.S.C. 661). A former principal benefit of the SBIC program was the ability to leverage private capital and SBA subordinated capital with third party debt. In 1993 and 1994, policy and regulations promulgated by the Small Business Administration (SBA) far exceeded the bounds of prudent safeguards in attempts to curtail third party financing. Increased capital requirements, new management standards, and substantial new SBA powers as a creditor more than adequately protects the government's interest.

Licensees must have the ability to access third party debt to be profitable, at least to the comparable extent of private finance companies. Private finance companies on average are leveraged 6-to-1. To restrict the number of Licensees in the program with higher levels of third party debt, SBA could permit only Licensees investing in smaller entrepreneurial concerns (i.e. $1 million net worth/$500,000 after tax net income) to access higher levels of third party debt. In addition, those Licensees would have a lower limit on investment as a percentage of capital (e.g., 15%).

Licensees with SBA leverage as described above should be able to leverage a total of 7-to-1, inclusive of SBA leverage. Third party debt will be senior to SBA leverage up to a maximum of $25 million, provided that the Licensee has minimum capital of $5 million.

Recommendation:

- Third party debt restrictions should be liberalized and based upon private sector debt-to-capital ratios.

- Licensees should be permitted to have up to 40 percent of their portfolio investments in short-term debt financings (i.e., less than 4 years).

- Licensees should be permitted to charge fees including processing and commitment fees (13 CFR 107.402), and management services fees (13 CFR 107.501) consistent with investment industry practices.

- Licensees should be given greater flexibility with respect to interest rate charges (i.e., 11% over the Treasury Bill rate)

to borrowers so that interest rates are more closely related to market conditions (13 CFR 107.302).

- To provide the proper financing structure in any given transaction, a variety of investment sources may be required. To adequately protect an investment, restrictions contained in 13 CFR Section 107.903(5)(c) that refer to "Joint Financing" should be modified to permit Licensees to invest with an entity defined by program regulations as an Associate without SBA approval.

VI. Participation in 7(a) Loan Guarantee Program

SBA has current discretionary authority to establish policies to make secondary market financing accessible to SBICs. Exercising such discretion would be a significant program improvement, particularly for SBICs principally engaged in debt-oriented transactions. By permitting Licensees to sell the guaranteed portion of SBA loans in the secondary market, Licensees could generate a much larger dollar volume of overall lending than would be possible utilizing only their own private capital and SBA leverage.

By virtue of their restricted investment activities and market niche, debt-oriented 301(d) Licensees maintain direct access to underserved entrepreneurs and markets, and have the capacity to perform the necessary credit analysis and loan servicing which is vital to the success of the 7(a) program. By allowing such Licensees to establish a separate corporate entity that would be authorized to participate in the 7(a) loan guarantee program, liquidity for the Licensee would be enhanced and debt financing would be increased for underserved small business enterprises in communities where necessary financing is unavailable through traditional lending channels.

In recognition of the limited resources available within SBA's Financial Services Division, NAIC recommends that SBA secure Congressional approval for more flexible personnel arrangements for the administration of the 7(a) loan guarantee program. NAIC believes that oversight of the expansion of the 7(a) loan guarantee program for Licensees is much better performed by private sector personnel. This can be accomplished by contracting out all of the administrative functions including licensing and regulatory compliance and oversight to qualified independent private sector personnel. In the alternative, SBA could engage in an agreement with another Federal regulatory agency (e.g. the Community Development Financial Institutions Fund) to provide licensing and regulatory oversight for Licensees approved as 7(a) lenders. The cost of contracting out the administrative functions in either case could be passed on to new 7(a) loan guarantee participant Licensees.

Recommendation:

- SBA should expand the 7(a) loan guarantee program to permit Licensees to establish a separate corporate entity, with minimum capitalization of $250,000, to qualify as participants in SBA's 7(a) loan guarantee program.

- To qualify for participation in the 7(a) loan guarantee program, Licensees must have operated in good standing for a period of five years.

- SBA should contract out all of the administrative functions including licensing and regulatory compliance and oversight to qualified independent private sector personnel, with administrative costs passed on to all program participants.

VII. Asset Securitization

Asset securitization has emerged as an important funding alternative to provide capital to companies. Increasingly, companies of all sizes are utilizing the new "financial technology" to obtain off balance sheet financing directly from the capital markets as opposed to traditional bank funding.

Securitization, in its most basic form, is the repackaging of asset cash flows into securities (i.e., asset pools) which are sold to investors. Asset-backed securities (ABS) are most often issued by a trustee or special purpose company through an underwriter, public offering or via a private placement. The asset cash flows are remitted to the trustee which pays the scheduled interest and principal payments to investors. The process is analogous to SBA-guaranteed SBIC Funding Corporation debenture offerings.

Asset securitization is encompassing more types of collateral with a variety of cash flow characteristics. Long term SBIC loans have characteristics which are amenable to securitization. Asset securitization will yield significant benefits to Licensees and to the SBIC program in general:

- It affords SBICs an opportunity to diversify funding sources by directly accessing capital markets.

- It will complement (or in some cases be an alternative to) SBA leverage.

- It will reduce SBIC third-party debt and reduce SBIC debt-to-equity ratios.

Recommendation:

SBICs should be permitted by Program regulations to form special purpose corporations as a 100%-owned subsidiary of Licensees for the purpose of conducting a securitization transaction. Specifically, SBIC Program regulations regarding the deposition of assets to Licensees' associates should be changed.

VIII. SBIC Program Funding

The potential for leveraging private capital is the critical incentive for seeking an SBIC license. However, since its inception, the SBIC Program has had to contend with fluctuations in funding levels. It is imperative that Program funding become more stable and predictable in order to attract new qualified participants and to allow Licensees to effectively achieve the investment objectives of the Program.

In light of NAIC's recommendations for consolidation to ensure the maximum amount of potential leverage during the transition period, it is critical that the current subsidy rates attributable to 301(d) securities be recalculated. New subsidy rates applicable during the transition should be based upon updated assumptions which more accurately reflect historical and prospective losses.

In 1989, Congress authorized SSBICs to repurchase 3% preferred stock sold to the SBA for less than par value. The statute authorizing the Three Percent Preferred Stock Repurchase Program requires that the funds received by the SBA be utilized for new SSBIC leverage (subject to annual appropriations). An amount in excess of $23 million has been received to-date by the SBA as a result of repurchase transactions. Although Congressional intent is clearly stated, these funds have not been made available as new leverage. These funds could leverage the roll-over of SSBIC debentures currently on demand or which will mature in the very near future. If a method to refinance these obligations is not established, the result will be a severe decapitalization in the current SSBIC program.

Currently SBICs and SSBICs may issue SBA guaranteed debentures with initial interest rate subsidies available for SSBICs. Congress has under consideration a proposal that would eliminate or severely limit the availability of debenture leverage. NAIC does not believe that elimination of debenture leverage would serve the public policy purposes of the SBIC program.

Recommendations:

Short-Term

- Existing SSBIC debentures on demand should be rolled over as new unsubsidized leverage for a minimum of one additional term (i.e., not less than 10 years). Funds received from SSBIC 3% stock repurchase transactions should be utilized for existing SSBIC borrowing and/or rollover of maturing debentures.

- Seek third party recalculation of subsidy rates computed for SSBIC securities (i.e. 4 percent preferred stock and subsidized debentures).

- Retain debenture leverage for Licensees. In the alternative, make debenture leverage only available to Licensees who predominately finance smaller entrepreneurial concerns (as defined herein).

- Permit Licensees to pay off debentures on a pro-rata basis coincident with the disposition of investments. Licensees should not incur prepayment penalties and should not be precluded from receiving additional leverage prior to the maturity date of the prepaid debenture.

Longer-Term

- Make the SBIC program self funding via creation of a Government-sponsored enterprise (GSE), so that no annual Federal appropriations are required.

IX. Access to Capital

Attracting private capital has historically been a critical issue for SSBICs and SBICs alike. Licensees have nurtured a significant number of small businesses which are now profitable enterprises. Jobs have been created and tax payments to the federal government by Licensees, portfolio companies and employees are well in excess of SBA leverage. The ability to accomplish even more is only constrained by a lack of capital. Within the Executive Branch, the SBA should strongly advocate changes to the Internal Revenue Code (the "Code"), the Investment Company Act of 1940, and other federal securities laws that would attract private capital flows to Licensees and small businesses.

Many Government reports and studies have documented the "capital gap" which afflicts small businesses. Businesses that are owned by minorities or disadvantaged persons in general, confront even greater barriers to accessing capital for earlier-stage investment, acquisitions or to finance growth. The capital shortage is also acute for existing SSBICs.

NAIC believes that targeted tax incentives, in particular for long term equity investment in existing SSBICs and in new Licensees which focus their financing activity primarily in smaller entrepreneurial concerns, can be a powerful method for closing the capital gap. In 1993, Congress enacted two tax provisions which, if modified and enhanced, could greatly assist Licensees in attracting private capital. New Section 1202 of the Internal Revenue Code (the "Code") established a 50% capital gains exclusion for investments in "qualified small business stock" ("QSB Stock"). Under a special rule, the stock of an SSBIC can qualify as QSB Stock (subject to certain restrictions). The tax benefits provided under Code Section 1202 are limited to non-corporate taxpayers and apply only with respect to equity in the form of QSB Stock.

The code sections noted above are only applicable to current 301(d) Licensees, as are the following recommendations. However, in a consolidated program, conforming amendments would be necessary to tie tax benefits to Licensees who predominately finance smaller entrepreneurial concerns.

Recommendations (Code Sec. 1202):

- Code Section 1202 should be modified so that the stock of SSBICs which are considered "regulated investment companies" under the Investment Company Act of 1940 ("the '40 Act") can qualify as QSB stock. Specifically, Code Section 1202(e)(4) should be modified.

- The capital gains exclusion under Code Section 1202 should apply to investors who acquire equity in a small business which may not be organized as a Subchapter C corporation, but which would otherwise qualify as an eligible small business.

- The benefits of Code Section 1202 should be made available to corporate investors as well as non-corporate investors.

Recommendations (New Code Section 1044):

New Code Section 1044 enacted in 1993 permits a taxpayer to defer payment of current tax or capital gains realized from the sales of publicly traded securities provided the taxpayer "rolls over" or reinvests the gain into the common stock of an SSBIC. At present, because of unduly restrictive requirements, Code Section 1044 has only been marginally effective in attracting capital to SSBICs. To enhance its potential for accessing new capital, Code Section 1044 should be modified as follows:

- The current law period within which taxpayers must "roll over" gains into an SSBIC should be extended from 60, to not less than 180 days.

- Under current law, annual and cumulative (i.e., lifetime) limits apply to the amount of gain that can be deferred. An individual may defer tax on no more than $50,000 of gain in any one year and $500,000 lifetime. A corporation may defer no more than $250,000 of gain in one year and $1 million lifetime. Rather than forcing a taxpayer to spread out permitted deferrals over several years, Code Section 1044 should be amended to permit deferral up to the lifetime limit in one year. Also, the lifetime limits should be increased.

- Deferral under Code Section 1044 should be available with respect to the purchase of any SSBIC equity interest (i.e., common stock or preferred securities). Similarly, Code Section 1044 should be amended also to permit deferral with respect to the roll over of gain from the sale or disposition of privately held securities.

- As an alternative to modifications to Code Sections 1044 or 1202, a targeted tax credit should be enacted for individuals or corporations who make long term equity investments in Licensees who predominately finance smaller entrepreneurial concerns.

- The Investment Company Act of 1940 and the Code should be conformed so as to achieve pass-through tax treatment to Licensees structured as regulated investment companies.

June 19, 1995

STATEMENT FOR HEARINGS ON SBIC PROGRAM
By Lee R. Petillon

TO: Senate Committee On Small Business
U.S. Senate
Senate Office Bldg. - Room 428A
Washington, DC 20510

RE: Small Business Investment Act of 1958, as Amended

This is to urge that your Committee recommend retention of the Small Business Investment Company Program under the Small Business Investment Act of 1958, and to expand the amount of leverage available for SBIC's to the full amount authorized by Congress in the Small Business Equity Enhancement Act of 1992.

I am a partner of a five lawyer law firm which represents almost exclusively small business concerns. I have practiced law for 35 years, and from 1960 to 1968 was counsel to a $45,000,000 SBIC in San Diego. During 35 years of practice, I have counselled many small businesses, particularly in their financial needs.

The importance of small business to the economy is undisputed: According to the Small Business Administration, there are approximately 20,000,000 small businesses in the United States which employ more than half of the domestic labor force, produce nearly half of the gross domestic product and are often the ones that develop new technologies, products and services. Almost all of the job growth in the last 20 years has come from small companies, as the Fortune 500 companies have, on balance, shed millions of jobs over this period. There is a direct relationship between the amount of equity capital available to small business and the growth of small business which in turn leads to development of new technologies, products and jobs.

The need in California for increased access to equity capital is acute. Governor Wilson has estimated that the state has lost over 800,000 jobs in the past four years. A study in 1993 by the Los Angeles County Aerospace Task Force estimated that Southern California has lost 170,000 defense/aerospace jobs since 1990 and will lose another 170,000 jobs in the next several years.

A recent study (copy enclosed) by the Economic Development Corporation of Los Angeles indicates that the five county region of Southern California - Los Angeles, Orange, Ventura, Riverside and San Bernardino - lags far behind the rest of the state in equity capital available to high technology companies. The study showed that slightly more than 17% of the venture capital funds disbursed to California high tech firms over the past decade went to companies based in the five county region, as compared to more than 65% of such funds which went to Bay Area firms. The number of companies receiving venture funding decreased by 50% from 1983 to 1993.

According to a national survey conducted by Price Waterhouse of venture capital investments across the country totalling $1.5 billion, only $62 million or about 4% of the national total was invested in Los Angeles and Orange Counties in approximately 13 small businesses.[1] This compares with $379 million or about 25% of the national total invested in Silicon Valley.

This paucity of venture capital is in stark contrast to the greatest concentration of top national engineering schools, half of California's business support services and technological employment and 45% of the state's technical firm that reside in the five county Southern California region. For a region attempting to transition itself from a defense-based economy to a commercial-based one, venture capital is a key element in fueling this transition, and commercializing $ billions of defense/aerospace technology by small technology firms. Attached to this letter is an article entitled "The State of Venture Capital" by Rohit K. Shukla, Director of the Los Angeles Regional Technology Alliance which undertook the EDC study referred to above.

Congress recognized the need of small businesses for equity capital in 1958 when they adopted the Small Business Investment Act. The venture capital industry was substantially expanded by the 1958 Act, and many SBIC's were formed in the 1980's and early 1990's.

SBIC's tend to fill a gap of equity capital for small business concerns that are unable to obtain financing from the institutional venture capital industry which only invests in a very small segment of small business.[2]

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[1] The SBA estimates that total investments by California SBIC's were only $97 million in 1993 and $105 million in the first nine months of 1994.

[2] A partner of a leading venture capital fund in Northern California, in answer to a question from Louis Rukeyser on "Wall Street Week" as to how many companies his fund looked at versus invested in, indicated that they reviewed

Unfortunately, the SBIC industry fell into dispute in the 1970's and 1980's, largely because of the mismatch of borrowed money on the one side, and long-term equity investments on the other, rendering those SBIC's unable to repay SBA loans and producing insolvencies for many SBIC's. Also, too many SBIC's were minimum capital SBIC's that did not have enough funds to retain competent managements.

These problems were remedied with the Small Business Equity Enhancement Act of 1992. According to the enclosed Wall Street Journal article, these companies have raised nearly $600,000,000 of private capital.

The new SBIC program has breathed new life into the small business community in the United States, and has generated new hope for a major increase in growth capital to develop new technologies, products and jobs.

For these reasons, I strongly urge your committee to favorably consider continuing the SBIC program and expanding the amount of leverage available to these SBIC's in the full amount authorized by Congress in the 1992 amendments.

Respectfully submitted,

Lee R. Petillon

cc: Hon. Jane Harman, Congresswoman, 36th District, California
Hon. Dianne Feinstein, Senator, California
Hon. Barbara Boxer, Senator, California
Hon. Philip Lader, Administrator, Small Business Administration

[Attachments to Mr. Petillon's statement have been retained in the Committee's permanent files]

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about 1,000 proposal a year, and invested in between 10 and 20 companies. It is the other 990 or 980 small companies for whom the SBIC industry could provide equity financing. These companies may not be the Intel's or Apple's, but could provide many thousands of jobs and add to California's economy.

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